Fordham Journal of Corporate & Financial Law

Volume 11, *Number* 2 2006 *Article* 2

The Political Dynamics of Corporate Legislation: Lessons From Israel

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ARTICLES

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TABLE OF CONTENTS

INTRODUCTION

Corporate law governs the operation of business organizations in a given state or country. Generally, it is conceived of as being a combination of permissive mechanisms designed to lower transaction costs for varied economic players and regulating mechanisms intended to smooth out embedded structural flaws. While the distinctions among the corporate laws of the various U.S. states have usually been explained on the basis of competition among the states,[1] the distinctions among the corporate laws (and especially the corporate governance structures and corporate finance patterns) of different countries have been explained on the basis of the existence of myriad exogenous conditions, such as market mechanisms, ownership structures, historical legal origins, and quality of enforcement.[2] Out of this latter sort of explanation, there has

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* Associate, Fried, Frank, Harris, Shriver & Jacobson LLP; J.S.D., Yale Law School, 2004; LL.M., Yale Law School, 2001; LL.B./MBA, Hebrew University of Jerusalem, 1998. This paper is largely based on a doctoral thesis entitled "Looking at Corporate Law through a Political Theory Lens – The New Israeli Corporate Law as a Case Study" (Feb. 2004) (unpublished manuscript, on file with the Yale Law School Library). I am deeply indebted to Roberta Romano for her enduring support and guidance as well as to Henry Hansmann and Alan Schwartz for their valuable advice. I would also like to thank Aviva Diamant for her insightful comments. Further, I wish to express my gratitude to Shuki Abramovich, Michal Agmon-Gonen, Aharon Barak, Amihud Ben-Porat, Sam Bronfeld, Joseph H. Gross, Reuven Y. Hazan, Meir Het, Menachem Hofnung, Davida Lahman-Messer, Dan Meridor, Arie Mientkavich, Michel Ohayon, Uriel Procaccia, Eran Rosman, Eliezer Sandberg, Amir Sharf, Zeev Sher, Ruth Shikler, Nathan Shilo, Gad Soen, Eyal Sulgenik, Shimon Wise and Omri Yadlin, who shared with me their experience and knowledge regarding the process that led to the enactment of the new Israeli Companies Law. Finally, I thank Kobi Abramov of the Tel Aviv Stock Exchange, Amir Bachar of Bank Israel, Rivka Marcus of the Knesset Archive, Yigal Mersel of the Supreme Court of Israel and Shelly Udvin-Aharoni of the Israel Securities Authority for granting me access to the formal records of the legislative process of the new Companies Law and current economic data.

1. For the different views regarding the efficiency of that competition, see William Cary, *Federalism and Corporate Law: Reflection upon Delaware*, 83 YALE L.J 663 (1974); Roberta Romano, *The State Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709 (1987). For cross-sectional empirical study of the effect of state law on firm value see Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525 (2001).

2. *See* Lucian A. Bebchuk & Mark J. Roe, *A Theory of Path Dependence in*

arisen a lively debate in recent years with respect to the possibility, or even the likelihood, of convergence of corporate codes toward a common standard.[3] And yet, this rich scholarship has thus far paid little heed to the way in which political factors impact corporate law legislation.

This paper attempts to fill this gap by providing its reader with a new and different outlook on the substance and structure of corporate law. It does so by examining the political history that accompanied the recent enactment of a new Israeli corporate law and placing this history in a firm framework of political theory. By tracing this law as its case study, the paper is able to trace the influence of interest groups on different stages of the legislative process and assess the implications of this particular instance for corporate law in general. As we explore the political history of the new law, we are also given some fascinating insights into the production process of corporate law and the complex relationship between theory and practice. Political theory will be the whetstone that we use to sharpen our understanding of this relationship.

Given that major mechanisms within the new Israeli law have been built upon common law arrangements and heavily influenced by American doctrines,[4] our exploration is sure to shed valuable light on the

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Corporate Governance and Ownership, 52 STAN. L. REV. 127 (1999); Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, *Law and Finance*, 106 J. POLITICAL ECONOMY 1113 (1998) [hereinafter La Porta et al., *Law and Finance*]; Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, *Investor Protection and Corporate Governance*, Working Paper Series (2000) [hereinafter La Porta et al., *Investor Protection and Corporate Governance*]; Jonathan R. Macey & Geoffrey P. Miller, *Corporate Governance and Commercial Banking: A Comparative Examination of Germany, Japan, and the United States*, 48 STAN. L. REV. 73 (1995).

3. For the conflicting opinions, compare Bebchuk & Roe, *supra* note 2, with Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001) and Henry Hansmann & Reinier Kraakman, *Toward a Single Model of Corporate Law? in* CORPORATE GOVERNANCE REGIMES: CONVERGENCE AND DIVERSITY (Joseph A. McCahery et al. eds. 2002). For an intermediate position see John C. Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications*, 93 NW. U. L. REV. 641 (1999) [hereinafter Coffee, *The Future as History*]; John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 YALE L.J. 1 (2001).

4. These mechanisms include, *inter alia*, board structure that includes outside directors, fiduciary duties (duty of loyalty and duty of care) and their enforcement

study of both Israeli and American corporate law, as it traces the interrelationships between interest groups and legal outcomes and assesses the suitability, or lack thereof, of specific legal regimes to distinctive market realities.

The new Israeli Companies Law came into force in February 2000.[5] It replaced the Companies Ordinance which had largely been based on the English Act of 1929 but which had since been reformed several times.[6] The legislative process that gave birth to the new law lasted for eighteen years and grounded itself on a proposal prepared by Professor Uriel Procaccia of the Law Faculty of the Hebrew University of Jerusalem.[7] This proposal was then slowly shaped into a bill by a public committee chaired by Supreme Court Justice, and later Chief Justice, Aharon Barak.[8] After the bill gained the preliminary approval of the Knesset, the Israeli Parliament, it was referred to a parliamentary committee that formulated the law's final version.[9] This paper argues that this unique legislative process facilitates examination of the impact that interest-group involvement has on the legislative process.

This paper's analysis of the legislative process that produced the new Israeli corporate law has generated two main findings. First, the interest groups that participated in the enactment of the Israeli Companies Law differed from those involved in the formulation of American corporate codes. The Bar, which is the driving force behind corporate law legislation in the United States, was far less dominant in the Israeli context.[10] And yet, the Israel Securities Authority, the equivalent of the Securities and Exchange Commission (SEC), in this case was highly involved in the process.[11] One explanation of these

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through derivative and class actions, and proxy voting.

5. *See* The Companies Law, 1999, S.C. 204 [hereinafter the Companies Law, 1999].

6. See Appendix A *infra* for main amendments in the Israeli corporate law and the legislative process of the Companies Law, 1999.

7. *See* URIEL PROCACCIA, A NEW CORPORATE LAW FOR ISRAEL (1989); Uriel Procaccia, *Crafting a Corporate Code from Scratch*, 17 CARDOZO L. REV. 629 (1996).

8. *See* THE COMMITTEE FOR THE LEGISLATION OF A NEW COMPANIES LAW, A REPORT (1994) [hereinafter BARAK COMMITTEE REPORT].

9. *See* THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, THE SETTING UP OF A SUBCOMMITTEE FOR THE COMPANIES LAW (Dec. 13, 1995).

10. *See infra* Part IV.A.

11. *Id.*

distinctions arises out of the different sets of incentives driving these groups, another, out of the differing political structures of the two countries.

The second of this paper's two main findings is that the modifications in legal arrangements, which happened during all the various stages of the legislative process of the new law, followed distinctive patterns. The changes made during the deliberations of the Barak Committee, for instance, were characterized by a shift from bright-line rules to standards and from enabling provisions to mandatory ones. In the course of the parliamentary discussions, on the other hand, many of the mandatory provisions were mitigated or otherwise reshaped.[12] Indeed, this last trend continued to the post-enactment refinements.[13] It is the contention of this paper that the involvement of various interest groups in the different stages of the lawmaking, and the dynamics among them, played no small part in shaping the variously distinctive patterns of legislation just mentioned.

The paper's findings have wide implications for both political theory and corporate law. Among others, they illustrate how various concepts of political theory play out within the sphere of corporate law legislation, such as the role played by the media and public opinion in constraining interest groups, the effect of legislators' personal ideologies on legislative outcomes, and the use of public interest rhetoric to advance private interests. Moreover, evidence regarding the involvement of interest groups in the various stages of the legislative process and the effect of this involvement on the end product has serious normative implications for corporate law. Specifically, political theory predicts that a legal arrangement arrived at as the result of an arm's length struggle among interest groups will be less susceptible to the disproportionate influence of one interest group at the expense of other groups or the public.[14] Thus, a thorough examination of the involvement of interest groups in the legislative process can provide us with a benchmark against which we can strive to assess the efficiency of the resulting legal outcome; arrangements that reflect the interests of a wide range of groups may be considered as normatively more desirable than those that reflect merely the special pleading of one narrow interest.

12. *See infra* Part III.B.
13. *Id.*
14. *See infra* Part I.A.

It is the ultimate aim of this paper to show that distinctive market and political realities affect both the chance of constructing successful legislation and the efficacy of the resulting legal arrangements. It may indeed be the case, as so many American legal scholars have suggested, that vigorous competition is the ultimate generator of shareholder wealth, in that it constrains the power wielded by interest groups. This paper proposes, however, that in the absence of such competition, a more regulated market represents the second-best way of reaching this goal.

The rest of this paper is comprised of four parts: Part I furnishes the reader with an overview of the political theory of legislation and its applications to corporate law, and outlines the political factors that affect corporate law legislation. The two ensuing parts present the case study of the new Israeli corporate law. Part II describes Israel's economic background, traces the political processes that accompanied the enactment of the new law, and depicts the participation patterns and relative strengths of relevant interest groups. Building upon these findings, Part III explores the new law's contents, with special attention being paid to the main modifications that were made during the legislative process, analyzes the impacts that the various interest groups have had on different segments of the legislation, and places the new Israeli corporate law within a political theory framework. Part IV offers some concluding remarks and policy recommendations.

I. THE POLITICAL THEORY OF LEGISLATION: OVERVIEW AND APPLICATION

Several contemporary political theories strive to explain political behavior in economic terms. These theories are generally referred to as "public choice theory." Public choice theory has been defined as the economic study of non-market decision-making.[15] With its basic notion being that political outcomes are best understood as a function of self-interested individual behaviors,[16] the idea here is that political actors, much like the classic economic actors, are rational, utility-maximizing players moving through a collective action market in pursuit of their

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15. *See* DENNIS C. MUELLER, PUBLIC CHOICE II 1-2 (Rev. ed. 1989) (1979).

16. *See* ANTHONY DOWNS, AN ECONOMIC THEORY OF DEMOCRACY 3-11, 27-28 (1957); JAMES M. BUCHANAN & GORDON TULLOCK, THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY 17-23, 31-39 (1962).

own private interests rather than public ones.[17] Formal models derived from this concept have been applied to such issues as voting processes, governmental performance, legislation, and the behavior of bureaucratic agencies. These models have found favor among legal thinkers most notably by bringing the judiciary into the mix.[18]

A. Interest Group Theory

One of the aspects of public choice that is most pertinent to the subject matter of this paper is interest-group theory. This theory focuses on the organization of groups, as opposed to individuals, and their relative advantage in gaining political influence.[19] It drops the naive concept of pluralism – that the practice of political grouping allows a society's majority interests to gain proportional representation – in favor of the more realistic notion of the disproportionate influence of interest groups on the political process.[20] In its economic version, often referred to as the economic theory of legislation, interest-group theory analyzes the aptitude of special interest groups to use the state for their own purposes under the supposition that all relevant actors act rationally from a political point of view.[21] According to the theory, the lawmaking process is a product that abides by the laws of supply and demand.[22] It

17. *See* JERRY L. MASHAW, GREED, CHAOS, AND GOVERNANCE: USING PUBLIC CHOICE TO IMPROVE PUBLIC LAW 11 (1997).

18. *See* Frank H. Easterbrook, *Ways of Criticizing the Court*, 95 HARV. L. REV. 802, 811-832 (1982); Frank H. Easterbrook, *The Supreme Court, 1983 Term-Foreword: The Court and the Economic System*, 98 HARV. L. REV. 4, 14-18, 42-58 (1984) [hereinafter Easterbrook, *The Court and the Economic System*]; William M. Landes & Richard A. Posner, *The Independent Judiciary in an Interest-Group Perspective*, 18 J.L. & ECON. 875 (1975); Richard A. Posner, *Economics, Politics, and the Reading of Statutes and the Constitution*, 49 U. CHI. L. REV. 263 (1982).

19. The seminal work regarding the factors affecting interest group formation is MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION (2d ed. 1971) (1965).

20. For the different conceptions of representative democracy, see Daniel A. Farber & Philip P. Frickey, *The Jurisprudence of Public Choice*, 65 TEX. L. REV. 873, 875-79 (1987).

21. *See* George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. OF ECON. & MGMT. SCI. 1 (1971). Though originally applied to economic regulation, the theory's implications extend to different fields of legislation, and this is the way it will be treated here. For the specific implication of the theory for the issue of delegation, see *infra* Part III.B.4.

22. For the development of the economic theory of legislation and its evaluation,

is controlled by competing political forces, which tend to advance the interests of certain groups in society rather than the well being of the public at large.[23] "In short, legislation is 'sold' by the legislature and 'bought' by the beneficiaries of the legislation."[24]

On the empirical front, the Schlozman and Tierney study in the 1980s remains the most extensive of organized politics.[25] Through a systematic examination of that decade's interest-group involvement in U.S. federal-level politics, the researchers were able to transform the rather stiff theoretical models into a more pliable analysis of the actual circumstances under which interest groups can be expected to influence the legislature effectively. Their conclusions were as follows.[26] First, interest groups are likely to affect legislative outcomes when the issue at hand is neither on the public agenda (highly visible to the public and/or the media) nor at odds with party lines or specific constituency needs. Second, lobbying that opposes legislation is more likely to succeed than is lobbying that supports legislation and seeks to alter the status quo.[27] Third, interest-group pressures tend to show up more in narrow, specific, and technical amendments than in the overarching construct of an entire piece of legislation. Fourth, interest groups are more likely to be effective when they do not encounter opposition, as in the case where a policy's costs or its benefits (but not both) are diffuse, or where there exists no policy entrepreneur or other group that stands in a close

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see Richard A. Posner, *Theories of Economic Regulation*, 5 BELL J. ECON. & MGMT. SCI. 335 (1974).

23. *See, e.g.*, Posner, *supra* note 18, at 265-68; Jonathan R. Macey, *Promoting Public-Regarding Legislation Through Statutory Interpretation: An Interest Group Model*, 86 COLUM. L. REV. 223, 227-33 (1986).

24. Landes & Posner, *supra* note 18, at 877. Throughout this work I would adopt this definition of supply and demand, that is, the legislature as supplier and interest groups as demanders of legislation. For a different approach that views the supply curve of legislation as an inverse demand curve, and politicians as brokers that pair demanders and suppliers of legislation, see Robert D. Tollison, *Public Choice and Legislation*, 74 VA. L. REV. 339, 341-44 (1988); ROBERT E. MCCORMICK & ROBERT D. TOLLISON, POLITICIANS, LEGISLATION AND THE ECONOMY: AN INQUIRY INTO THE INTEREST-GROUP THEORY OF GOVERNMENT 15-27 (1981).

25. *See* KAY L. SCHLOZMAN & JOHN T. TIERNEY, ORGANIZED INTERESTS AND AMERICAN DEMOCRACY (1986).

26. *Id.* at 314-17.

27. This is due to the institutional patterns of the American political process.

relationship to the relevant policymaker, be the latter an administrative agency or a member of a legislature. Fifth, and finally, the influence of interest groups is inevitably enhanced when they have an abundance of resources to draw upon and when they are able to work closely with such institutional coalitions as congressional caucuses. Schlozman and Tierney's all-encompassing suggestion is that although our instinct is right and pressure politics do indeed tend to benefit affluent minorities, nonetheless, even the broader, relatively disadvantaged public is still able to affect policy making through direct and indirect representation, electoral and social movements, and the initiatives set forth by public officials.[28]

In an effort to reconcile the economic theory of legislation with both the rhetoric and the factual evidence of public interest legislation, Levine and Forrence have developed a model which they believe allows one to predict the outcome of a political process.[29] Drawing on political analysis and on information and agency theory, they advance the general hypothesis that slack (i.e., policy discretion on the part of the regulator caused by the principal-agent relationship between voters and representatives) tends to impede general-interest regulation.[30] Such slack can be reduced via different means, such as incumbent self-publicity; political competition; organizations, such as trade associations or single-issue organizations, which can raise public awareness of issues; those scholars who constitute the public-policy intelligentsia; and the news media.[31] Ultimately, however, if any piece of general-interest regulation is to prevail, the issue it addresses has to be placed on the public agenda.[32]

Despite the seeming crudeness of Levine and Forrence's model, it does in fact serve to sharpen interest-group theory in three important

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28. *See* SCHLOZMAN & TIERNEY, *supra* note 25, at 398-403.

29. *See* Michael E. Levine & Jennifer L. Forrence, *Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis*, 6 J. L. ECON. & ORG. 167 (1990) (Special Issue).

30. *Id.* at 176-82 (asserting that slack allows a regulator to function without being perfectly observed by the polity, thereby encouraging it to adopt policies that are designed either to maximize its own private utility or to further its own conception of the public good).

31. *Id.* at 183-89 (discussing in turn the measures regulators have enacted protectively and proactively to reduce the effects of slack).

32. *Id.* at 191-94 (demonstrating that placing an issue on the public agenda dramatically reduces information costs, which in turn drastically reduces slack).

respects. First, it suggests that most of the public interest rhetoric mouthed by legislators simply represents their attempt to economize monitoring costs by drumming up public support.[33] Second, it distinguishes between two forms of ideological policy adopted by the regulator: one, the "general-interest policies," would be ratified by the public in keeping with accepted aggregation principles in the absence of information, organization, transaction, and monitoring costs; another, the "Burkean policies," are merely a form of ideological consumption by legislators – other-regarding acts that will not garner general support.[34] Third and last, Levine and Forrence's model makes it clear that a general-interest policy – a policy ratified by an informed public, absent monitoring costs – does not necessarily result in an efficient outcome, nor is it otherwise normatively warranted.[35]

Before we turn to a discussion of the various applications of interest-group theory to corporate law, a general caveat is in place. The focus of public choice on the rationality of the political actors does not necessarily imply that ideology, morality, and the public interest exert little or no force as motivators of individual and collective action. To the contrary, it is precisely those factors that have served as benchmarks for all those trying to assess the validity of interest-group theory.[36] It is the treatment of individuals as rationally self-interested that facilitates

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33. *Id.* at 180; *cf.* Posner, *supra* note 22, at 355 (examining the application of the economic theory of fraud to the public interest rhetoric).

34. *See* Levine, *supra* note 29, at 176-82. Burkean policies include policies that the public would ratify if it knew about them, as well as policies that the public would not support but that the regulator nevertheless believes the public ought to support.

35. *Id.* at 178; *see also* Einer R. Elhauge, *Does Interest Group Theory Justify More Intrusive Judicial Review*, 101 YALE L.J. 31, 59 (1991) (arguing that "majoritarian baselines are normatively unattractive because they do not account for the varying intensity of individual preferences"); Posner, *supra* note 18, at 266 ("The properties that make legislative redistributions feasible have nothing to do with the public interest, whether defined in efficiency or equity terms.").

36. *Compare* Farber & Frickey, *supra* note 20, at 890-901 (criticizing economic models of legislation for rejecting ideology as a significant factor in the political process) *and* DANIEL A. FARBER & PHILIP P. FRICKEY, LAW AND PUBLIC CHOICE, 21-33 (1991) (same) *with* Michael E. DeBow & Dwight R. Lee, *Understanding (and Misunderstanding) Public Choice: A Response to Farber and Frickey*, 66 TEX. L. REV. 993, 996-1002 (1988) (using the law of demand to argue that the importance of public interest and ideological commitment in political decision-making is consistent with the self-interest postulate of public choice) *and* Tollison, *supra* note 24, at 352-53.

the notion that the processes of political decision-making are not primarily or exclusively driven by an amorphous altruism.

It also needed to be noted, in this context, that even the most enthusiastic scholars working in this area have conceded that the salience of their work is to be found not so much in its irrevocability or in its compatibility with reality as in the openness of thought it evokes.[37] Moreover, current legal work asserts that the most important merit of public choice is that it demonstrates the significance of institutions in determining political outcomes,[38] which leads to my aim in applying public choice to corporate law. My intention is to provide a new outlook on the process of corporate legislation by delineating certain attributes of political theory that tend to affect it. It is by no means my intention to take an uncompromising, purely public choice based stand that rudely elbows aside all of the best and most traditional justifications for corporate legislation.

B. Applications to Corporate Law

When one looks at the matter from the perspective of economic theory, the same notions that underlie interest-group theory are at the core of modern corporate law; namely, self-interested actors, collective action problems, and slack, which is the result of agency relationships. It comes as no surprise, therefore, that the Berle-Means sort of

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37. *See, e.g.*, Geoffrey Brennan & James M. Buchanan, *Is Public Choice Immoral? The Case for the "Nobel" Lie*, 74 VA. L. REV. 179, 180 (1988) ("[T]he more appropriate use of the *homo economicus* construction is to further the normative exercise of investigating the incentive structures embodied in various institutional forms rather than the descriptive exercise of providing predictions as to the likely outcomes of political interactions."(citation omitted)); Tollison, *supra* note 24, at 368 (concluding that an economic theory of legislation "is by no means the only approach to legislatures, but it is provocative to think of the legislature as an institution guided by private interest"); Posner, *supra* note 18, at 269 (concluding that "the public interest and interest group theories are, at least in some mixture, complementary rather than antagonistic").

38. *See* David A. Skeel, Jr., *Public Choice and the Future of Public-Choice-Influenced Legal Scholarship*, 50 VAND. L. REV. 647, 663-70 (1997) (reviewing MAXWELL STEARNS, PUBLIC CHOICE AND PUBLIC LAW: READINGS AND COMMENTARY (1997)); Maxwell L. Stearns, *Restoring Positive Law and Economics: Introduction to Public Choice Theme Issue*, 6 GEO. MASON L. REV. 709, 722-25 (1998). Professors Skeel and Maxwell refer to this comparative institutional analysis as "the second wave of public-choice-influenced legal scholarship."

dispersed-ownership corporation is subject to the agency costs that arise out of the inherent conflict of interests between shareholders and managers.[39] After one has postulated a self-interested legislature and reminded oneself that ultimately the goal of corporate law legislation is the maximization of shareholder wealth,[40] however, the question that emerges as most essential is this: how (and to what extent) is a legislature able to resist its inclination to benefit managers and/or other interest groups at the expense of dispersed shareholders?

Several studies have used interest-group models to explain corporate law legislation, identify the groups that could benefit from such legislation, and describe the interrelationships between those groups. The common denominator linking these economic models is their vision of corporate law legislation as arising out of the competition among interest groups. While the pertinent interest groups in this context can be depicted by and large as such classic corporate players as managers, shareholders and creditors, a closer look brings a more complex picture into view.

To begin, both the attributes of a specific group and its ability to influence the political process depend upon its identity, its cohesion, and

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39. *See* Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV 469, 479-80 (1987) (noting that "in publicly held firms, the benefits of monitoring, bonding, and contracting [on the part of managers and shareholders] will be spread among the shareholding population *pro rata*, but the costs will be concentrated upon whichever shareholder takes it upon herself to attempt to control the managers").

40. For a different approach for the corporate purpose, see FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 67-70 (1991) (describing relational-oriented models that undermine the basic assumption of the economic approach to corporate law, according to which shareholders, as residual equity claimants, are the best risk bearers among the corporate constituencies and therefore the best monitors of management). For the reconcilement of this approach with a contrarian one, see Oliver E. Williamson, *Corporate Governance*, 93 YALE L.J. 1197 (1984) (concluding that transaction cost economics results in regarding the board of directors principally as a governance instrument of the shareholders); Jonathan R. Macey, *Symposium: Fiduciary Duties as Residual Claims: Obligations to Nonshareholder Constituencies from a Theory of the Firm Perspective*, 84 CORNELL L. REV. 1266 (1999) (arguing that the nexus-of-contract paradigm includes the shareholder-primacy paradigm, but does not necessarily lead to the same corner solution).

its size.[41] Thus, there must be room within the rubric "managers" for high-ranked professional employees, entrepreneurs, and control holders; within "shareholders" for entrepreneurs, individual control holders, families, institutional investors (e.g., mutual and pension funds), financial institutions (e.g., investment banks and insurance companies), speculators, and widely dispersed small shareholders; and, within "creditors" for financial institutions (e.g., commercial banks that may or may not be separated from investment banks), institutional investors, and other debt holders. The second point is that, in addition to managers, shareholders, and creditors, other groups may very well have some impact. Three in particular come to mind: regulatory agencies,[42] workers, and such business-service providers as lawyers, accountants, exchanges, and other financial intermediaries. In this regard, one also sees how the relevant interests and coalitions are likely to continually realign themselves around the ever-shifting issues, with the most basic example of this being the way the interest of managers and shareholders will collide in some cases and coincide in others. Then too, coalitions between managers and shareholders may well hinge not just on their own interrelation but also on their dealings with other groups, such as creditors and lower-level employees.

Whether it be groups that supply corporate services, groups that constitute the corporate entity, or groups that are affected by corporate activities, one thing is certain: all are dependent upon and passionately interested in any legislative outcome that will impinge, however remotely, upon their functioning. To put the matter differently, all relevant interest groups are consumers of the legislative process who exploit comparative advantage in pursuit of self-interest. Given that reality, one better appreciates the need to examine some of the more prominent of the interest-group schemes offered by the literature before one glibly attempts to apply interest-group theory to corporate law legislation.

For more than a decade, corporate legal scholars have been delving

41. *See* OLSON, *supra* note 19; MANCUR OLSON, THE RISE AND DECLINE OF NATIONS: ECONOMIC GROWTH, STAGFLATION, AND SOCIAL RIGIDITIES, 17-20 (1982). *See also*, MUELLER, *supra* note 15, at 307-19.

42. On the political role of regulatory agencies, see Jonathan R. Macey & David D. Haddock, *Shirking at the SEC: the Failure of the National Market System*, 1985 U. OF ILL. L. REV. 315 (1985); Roberta Romano, *The Political Dynamics of Derivative Securities Regulation*, 14 YALE J. ON REG. 279 (1997).

into the political history of specific laws, trying to assess the impact of political determinants on outcomes and evaluating the prospects for reform.[43] Specifically, the analysis of political history has been used for the study of corporate finance; state takeover laws and the Williams Act; corporate political speech; bankruptcy law; corporate two-tier taxation; and securities, derivatives, and international financial regulation.[44] In most cases, such analysis has been conducted by examining voting patterns, the testimony provided at congressional hearings, and other legislative materials. In some cases, it has also involved inquiry into such aspects of congressional bills as content, amount, sponsorship and connection to a specific market activity, and the gathering of empirical evidence on public opinion.[45] And yet, probably due to the longstanding existence of American corporate codes, such studies have not provided us with any evaluation of the legislative process of corporate law as a whole. Rather, they have served to illuminate various substantive aspects of the law.

Legal scholars have also turned to economic models in their attempt to ascertain a more general pattern of corporate law legislation. Jonathan Macey and Geoffrey Miller have, for instance, depicted the Delaware system of corporate law as being a *de facto* political equilibrium arrived at via the struggle between the Delaware Bar, on the one hand, and the various interest groups seeking to expand that state's

43. *See infra* note 44.

44. *See* MARK J. ROE, STRONG MANAGERS WEAK OWNERS: THE POLITICAL ROOTS OF THE AMERICAN CORPORATE FINANCE (1994); Jennifer Arlen & Deborah M. Weiss, *A Political Theory of Corporate Taxation*, 105 YALE L.J. 325 (1995); Enrico Colombatto & Jonathan R. Macey, *A Public Choice Model of International Economic Cooperation and the Decline of the Nation State*, 18 CARDOZO L. REV. 925 (1996); Mary E. Kostel, *A Public Choice Perspective on the Debate over Federal versus State Corporate Law*, 79 VA. L. REV. 2129 (1993); Paul G. Mahoney, *The Political Economy of the Securities Act of 1933*, 30 J. LEGAL STUD. 1 (2001); Eric A. Posner, *The Political Economy of the Bankruptcy Reform Act of 1978*, 96 MICH. L. REV. 47 (1997); Roberta Romano, *The Future of Hostile Takeovers: Legislation and Public Opinion*, 57 U. CIN. L. REV. 457 (1988) [hereinafter Romano, *The Future of Hostile Takeovers*]; Romano, *supra* note 42; Robert H. Sitkoff, *Corporate Political Speech, Political Extortion, and the Competition for Corporate Charters*, 69 U. CHI. L. REV. 1103, 1128-38 (2002).

45. *See* Arlen & Weiss, *supra* note 44, at 333-35; Romano, *The Future of Hostile Takeovers, supra* note 44, at 470-503; Romano, *supra* note 42, at 297-300.

treasury, on the other.[46] These authors also have postulated, within the context of the competition for corporate chartering among the states and the question of its efficiency, that "Delaware's dominance in the corporate chartering market stems from the fact that its substantive law rules benefit those ultimately responsible for the incorporation decision"[47] – namely, shareholders, managers, attorneys, and investment bankers – and that this dominant position is maintained through Delaware's credible commitment to keeping its corporate law highly attractive to corporate managers in the future.[48] The authors' main argument is that the premium created by Delaware's market power is exploited by the various interest groups operating within the state, and that the Delaware Bar reaps a disproportionate share of this bounty.[49]

Three aspects of Macey and Miller's theory stand out as most salient. First, although the authors criticize both the race-to-the-bottom and the race-to-the-top approaches to corporate law, they nonetheless presuppose that corporate law legislation in the United States, although not optimal, is still efficient.[50] This assumption is implicitly grounded in the notion that interstate competition for corporate charters benefits shareholders.[51] This notion is, in turn, predicated on the belief that

46. *See* Macey & Miller, *supra* note 39. For a similar interest group model explaining the SEC action with regard to American national market system, see Macey & Haddock, *supra* note 42.

47. Macey & Miller, *supra* note 39, at 487.

48. *See* Macey & Miller, *supra* note 39, at 484-91; ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 37-44 (1993); *cf.* Douglas M. Branson, *Indeterminacy: The Final Ingredient in an Interest Groups Analysis of Corporate Law*, 43 VAND. L. REV. 85 (1990) (contending that Delaware's continued primacy is the result of the balancing among different interest group, including one that was neglected by Macey and Miller, namely, the shareholder's or plaintiff's counsels); William W. Bratton, *Fiduciary Duty, Limited Liability, and the Law of Delaware: Delaware Law as Applied Public Choice Theory: Bill Cary and the Basic Course After Twenty-Five Years*, 34 GA. L. REV. 447 (2000) (developing a multiple demand model of Delaware regulatory capture to explain its tilt toward management, while acknowledging the threat of federal intervention and the role of the judiciary in constraining this tilt and protecting shareholder interest, at least to some extent).

49. *See* Macey & Miller, *supra* note 39, at 491-509. *See also* David A. Skeel, Jr., *The Unanimity Norm in Delaware Corporate Law*, 83 Va. L. Rev. 127, 156-62 (1997) (suggesting that the unanimity on the Delaware Supreme Court is meant, among others, to benefit Delaware's lawyers).

50. *See* Macey & Miller, *supra* note 39, at 479-83.

51. For empirical support of this premise, see Roberta Romano, *Law as a Product:*

agency problems are mitigated, and shareholder wealth enhanced, by a combination of efficient markets and enabling and flexible legal provisions.[52] Anyone seeking to assess the impact of political influence on corporate law legislation must take into account the vital role played by these assumptions. In this regard, it should be noted that some doubts have been raised recently as to the degree and even the mere existence of state competition for corporate charters in the United States,[53] and yet even this scholarship concedes that Delaware's dominance in the incorporation market is not entirely unchallengeable, given the constraints imposed on it by weak state competition and the threat of federal intervention.[54]

Some Pieces of the Incorporation Puzzle, 1 J.L. ECON. & ORG. 225, 265-73 (1985); Daines, *supra* note 1. For an overview of the empirical literature, see Roberta Romano, *The Need for Competition in International Securities Regulation*, 2 THEORETICAL INQUIRIES L. 387, 494-507 (2001) [hereinafter Romano, *The Need for Competition*] ("[a]dvocat[ing] opening up international securities regulation to greater regulatory competition than the scant competition that exists at the present").

52. *See* Macey & Miller, *supra* note 39, at 484-85; ROMANO, *supra* note 48, at 14-16.

53. *See* Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L. J. 553 (2002) (arguing that there exists no active competition among states for corporate charters and that Delaware's dominance is much stronger than has been previously recognized); Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205, 1212-14 (2001) [hereinafter Kahan & Kamar, *Price Discrimination*] (discussing the sources of Delaware's market power and noting that other U.S. states and foreign countries have failed to compete with Delaware in the market for incorporations); Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679 (2002) [hereinafter Kahan & Kamar, *The Myth of State Competition*] (showing that "[o]ther than Delaware, no state is engaged in significant efforts to attract incorporations of public companies"). *But see* Romano, *The Need for Competition*, *supra* note 51, at 507-13 (contending that other states but Delaware engage in "defensive" competition, i.e., aim at refraining local corporations from reincorporating in Delaware).

54. *See* Kahan & Kamar, *The Myth of State Competition*, *supra* note 53, at 739-43; Bebchuk & Hamdani, *supra* note 53, at 586, 604-05. At the risk of being accused of over-cynicism, one might suspect that the assessments of the efficacy and the strength of the above mentioned constraints are derived from the writers' presupposition regarding the warranty of federal intervention in corporate law, rather than the other way around. *Cf.* Mark J. Roe, *Delaware's Politics*, 118 HARV. L. REV. 2491 (2005) ("Views on whether more federal action is wise depend not only on which outcome the

The second of Macey and Miller's valuable points emerges out of their discussion of Delaware's credible commitment to keeping its corporate law manager-friendly. They note that since the physical assets of most large Delaware corporations are located in other states, other groups that are likely to have an interest in those assets, such as unions, environmental groups, and local communities, are absent from the political scene.[55] When, however, corporate assets are located in the jurisdiction within which the corporation has been incorporated, as holds true of national unitary corporate codes and of the corporate laws of other U.S. states for that matter,[56] the pressures extended by the aforementioned groups will very much need to be taken into account.

Third, and finally, the authors illustrate how greatly legislative outcomes are impacted by interest groups' access to political institutions and such attributes of interest groups as size, stakes in the matter, and organizational ability.[57] When one peruses another piece penned by Geoffrey Miller, one sees how this approach has general applicability to

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speaker prefers, but also depend on which outcome the speaker anticipates from Washington.").

55. Macey & Miller, *supra* note 39, at 490. *See also* Romano, *The Need for Competition*, *supra* note 51, at 529-39 (asserting that Delaware's unique political dynamics is one of the reasons for its relatively mild takeover statute and therefore for its superiority over other states or national legislative output); Sitkoff, *supra* note 44, at 1139-52 (mentioning this unique political environment as the reason for Delaware's "reduced likelihood of political rent extraction regarding corporate law," that in turn espouses Delaware's credible commitment towards its corporation). *But see* Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1437, 1505-07 (1992) (claiming that the presence of other interest groups but managers and shareholders in the federal arena would likely to result in the adoption of more socially desirable corporate rules).

56. *See* Bebchuk & Hamdani, *supra* note 53, at 564-72 (evidencing a significant "home-state bias", i.e., in-state incorporation pattern, among public companies that incorporate outside of Delaware. Specifically, they found that while 58% of all public companies are incorporated in Delaware, 33% are incorporated in their home state).

57. *Id.* at 498-509. *See also* Marco Pagano & Paolo Volpin, *The Political Economy of Corporate Governance*, CSEF Working Paper No. 29 (1999) (analyzing the principal relations between investor protection and employment protection as a function of political agreements among entrepreneurs, outside investors, and workers); Raghuram G. Rajan & Luigi Zingales, *The Great Reversals: The Politics of Financial Development in the 20th Century*, 69 J. FIN. ECON. 5 (2003) (Tuck Special Issue) (attributing time series variations in financial development across countries to the incentives and ability of domestic incumbent industrialists and financiers to oppose development).

the political theory of corporate law. In that piece, Miller shows how the differing approaches to federalism in the United States and in England can result in very dissimilar regulations of takeovers and of shareholders' derivative litigation, owning to the differences in the political influences exerted, in each of these countries, by the local bar and/or such interest groups as potential targets and bidders.[58]

William Carney has extended the model offered by Macey and Miller in an attempt to trace the corporate law legislative patterns of other U.S. states beyond just Delaware.[59] Carney's model postulates jurisdictional competition among the chartering states, which possess differing degrees of market power. The corollary here is that, "larger states, less dependent on chartering revenues and with more local interest groups likely to benefit from corporate laws, will adopt more rent-seeking provisions,"[60] since they face lower elasticity of demand for a cost-minimizing corporate law and higher elasticity of demand for the private benefits likely to be derived from the legislation.[61] Carney's more specific assertion is that the development of corporate law in U.S. states other than Delaware has been initiated by local corporate lawyers and corporate managers, with each of these seeking to extract rents through the modification of state corporation laws.[62] Marcel Kahan and Ehud Kamar make essentially the same point by surmising that state

58. *See* Geoffrey Miller, *Political Structure and Corporate Governance: Some Points of Contrast between the United States and England*, 1998 COLUM. BUS. L. REV. 51 (1998); *Cf.* ROMANO, *supra* note 48, at 28-31 (asserting that the relationship between the bar and the legislature and the judiciary can affect, at least marginally, the legal outcome).

59. *See* William J. Carney, *The Political Economy of Competition for Corporate Charters*, 26 J. LEGAL STUD. 303 (1997) [hereinafter Carney, *Political Economy*]; William J. Carney, *The Production of Corporate Law*, 71 S. CAL. L. REV. 715 (1998) [hereinafter Carney, *The Production of Corporate Law*].

60. Carney, *Political Economy*, *supra* note 59, at 305-06. Rent-seeking is the extraction of economic rents beyond those available in market transactions. *See id.* at 305.

61. *See id.* at 307-09.

62. *See* Carney, *The Production of Corporate Law*, *supra* note 59, at 717-28 (analyzing the benefits and collective action problems associated with each of those groups and noting the limited role of other interest groups such as shareholders, employees, customers, suppliers, and local governments in shaping corporate law in the United States). *See also* Bebchuk & Hamdani, *supra* note 53' at 606-07 (reaching the same conclusion under the assumption of weak competition).

lawmakers tend to create corporate laws that align with their own political interests rather than conduce to efficiency ends.[63]

Carney acknowledges, however, that competition in the capital and the chartering markets does constrain rent-seeking; he cites the vital role played by the common markets in limiting the power of interest groups.[64] Accordingly, he argues that substantial benefits to interest groups are to be expected in countries that employ tariff barriers to evade product market competition and are able to stave off jurisdictional competition by barring the egress of local firms.[65] His analysis of the differences between American and European corporate law lead Carney to conclude that the conspicuously more regulated European corporate law has come about through the participation of interest groups – creditors, managers, and employees – in the lawmaking process of the European Community's company law directives.[66]

Finally, Mark Roe has recently revisited the role of Delaware in shaping American corporate law, focusing on the public choice structure of the relationship between Delaware and the federal government.[67] His argument is that Delaware corporate law, which is designed to benefit its primary interest groups, shareholders and managers, is constrained by the threat of federal action that may "bring to the table players who are cut out in Delaware."[68]

Roe's analysis emphasizes the importance of competition, albeit not

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63. *See* Kahan & Kamar, *The Myth of State Competition*, *supra* note 53, at 727-38. *But see* Bebchuk & Hamdani, *supra* note 53' at 584-85 (noting that the political explanation offered by Kahan & Kamar regarding the disincentives of states to attract corporation, while convincing with respect to large states, does not fully explain the behavior of small states).

64. *See* Carney, *The Production of Corporate Law*, *supra* note 59, at 726-28, 754-55; Carney, *Political Economy*, *supra* note 59, at 311-18. *See also* Kahan & Kamar, *The Myth of State Competition*, *supra* note 53, at 739-41 (recognizing the constraints posed by the chartering market and the threat of federal intervention, at least in the case of Delaware).

65. *See* Carney, *Political Economy*, *supra* note 59, at 309-11 (noting that "[o]nly a system that insulated local corporations from product market competition would protect corporations (at least in part) from the adverse effects of competition from firms chartered under less costly legal regimes").

66. *See id.* at 318-29.

67. *See* Roe, *supra* note 54.

68. *See id.* at 2496.

in the state-to-state level, but rather in the state-to-federal playing field.[69] It also sharpens our understanding of the unique political structure of Delaware and how the federal shadow brings about moderation in Delaware and curbs managerial autonomy.[70] Thirdly, Roe's analysis sets the Delaware-to-federal relationship in a political theory context, envisioning Delaware as an institutional mechanism that enables the American polity to defer to managers and shareholders on most corporate law issues.[71]

In sum, from the existing literature on the political economy of corporate law, it can be inferred that both the nature and the relative strength of the various interest groups involved in the legislative process significantly affect the outcome of the legislation. Within the sphere of American corporate law, this influence usually is viewed as a form of rent-seeking that produces inefficient and sub-optimal laws. As for other nations, the implications of interest-group involvement for the quality of their corporate laws hinge largely on a nation's socio-economic and institutional characteristics, chief among these being ownership structure; capital market magnitude and efficiency; existence or lack of a market for corporate control; concentration of the economy and degree of cross ownership; dominance of banks in the economy; and the extent to which labor is organized.[72] The three basic goals of this

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69. Interestingly, although Roe questions the importance of competition in comparison to the differing public choice array in Delaware and in Washington, *see id.* at 2495-96, he concedes that Delaware has an interest in minimizing federal influence. *See id.* at 2518-19.

70. *See id.* at 2500-02, 2504-11 (asserting that Delaware's franchise tax empowers the interests of managers and shareholders while neutralizing other interest groups and demonstrating that ultra-pro manager lawmaking will goad Congress to act). Note that by "shareholders" Roe refers to institutional investors rather than the ultimate stockholders. *See id.* at 2502 n.6 ("Delaware law may not correspond to what *ultimate* investors would agree to with industrial managers. It is what investors' two types of managers – financial and industrial – want.").

71. *See id.* at 2511-13, 2540-41.

72. There is substantial financial literature relating several of these socio-economic and institutional factors to the content of corporate and securities codes. *See, e.g.*, Steven Kaplan, *Corporate Governance and Corporate Performance: A Comparison of Germany, Japan and U.S.*, 9 J. APPLIED CORP. FIN. 86 (1997); Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, *Corporate Ownership Around the World*, 54 J. FINANCE 471 (1999) [hereinafter La Porta et al., *Corporate Ownership*]; Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer &

paper are: to analyze how the above-cited characteristics foster the dominance of various interest groups within an economy; to trace the interplays among these groups and their shifting coalitions with respect to a myriad of corporate issues; and to spell out some of the normative implications of interest-group involvement in the legislative process. At the paper's center, and serving as its case study, is the aforementioned new Israeli corporate law, with the paper's general conclusions being largely based on the findings with respect to that law and the placing of these findings in a comparative context.

II. BACKGROUND ON THE NEW ISRAELI CORPORATE LAW: ECONOMY, POLITICAL HISTORY, AND RELEVANT INTEREST GROUPS

Israel is an attractive case study of the political model for three reasons. First, Israel can be seen as a hybrid of common law and European market attributes. The 'old' corporate law was based upon the English Act of 1929 and had been developed through independent legislation, as well as through judicial precedents that were inspired by English and American doctrines.[73] However, the Tel Aviv Stock Exchange (TASE), the sole national exchange, was established in the 1930s by European immigrants, who brought with them the tradition of the continental exchanges and banking laws.[74] The TASE Trading Rules were later drawn after the London Stock Exchange Rules; the 1968

Robert W. Vishny, *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997); Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, *Investor Protection and Corporate Valuation*, NBER Working Paper No. W7403 (1999) [hereinafter La Porta et al., *Investor Protection and Corporate Valuation*]; Davide Lombardo & Marco Pagano, *Law and Equity Markets: A Simple Model*, University of Salerno Working Paper No. 25 (1999). However, this literature does not investigate the effect of these factors on the political process of corporate law legislation, which will be the focus of this paper.

73. *See, e.g.*, C.A. 817/79 Cosoi v. Y.L. Foictonger Bank Ltd., Piskey Din 38(3) 253 (Isr.); A.D. 39/80 Bardigo v. D.G.B. 9 Textile Ltd., Piskey Din 35(4) 197 (Isr.); C.A. 524/88 "Pri Ha'emek" Agricultural Cooperative Society Ltd. v. Sde Yaacov, Piskey Din 45(4) 529 (Isr.). Until 1980 the application to English Common Law and Equity in case of lacuna was mandatory. This requirement was annulled with the enactment of the Legal Foundations Law, 1980.

74. The legal entity "The Tel Aviv Stock Exchange Ltd." was incorporated some 20 years later, in 1953. *See* http://www.tase.co.il/html2/about/overview/history.htm; Interview with Saul Bronfeld, Managing Director, the TASE, in Tel Aviv, Israel (July 17, 2002) (on file with author).

Securities Law, which created the regulatory framework for the operation of the TASE, was largely influenced by the American federal securities regulation.[75]

Israel's market characteristics reveal a concentrated economy with large, though ostensibly declining, government involvement.[76] Market mechanisms, intended to mitigate agency problems, are either non-existent or poorly functioning.[77] Given these market realities, an examination of the interaction between markets and corporate law legislation in the Israeli case can provide a base for fruitful comparative research on the impact of different economic environments on legal regimes and vice versa.

Second, the new corporate law is a comprehensive reform, including both amendments to statutory provisions and codification of judicial doctrines.[78] Thus, it enables not only the examination of discrete corporate issues standing alone, but also their coherence and reciprocity.

Finally, the unique drafting process of the new law, based on a proposal by a prominent academic figure that was then refined by a public committee and through the ordinary apparatus of a parliamentary committee, facilitates tracking the influence of political forces at different stages of the legislation and their ultimate impact on the resulting statute.[79]

This part lays the foundations for the analysis of the political economy of corporate law legislation that is developed in the subsequent part. It furnishes a succinct account of Israel's economy and market structure as well as a description of the political history of the new Companies Law. It further defines the relevant interest groups in the Israeli context and depicts the participation patterns of each of these groups in the legislative process of the new law.

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75. *Id.*

76. *See infra* Part II.A.

77. *See* Zohar Goshen, *Controlling Corporate Agency Costs: A United States – Israeli Comparative View*, 6 CARDOZO J. INT'L & COMP. L. 99, 111-16 (1998); Procaccia, *Crafting a Corporate Code from Scratch*, *supra* note 7, at 639-40.

78. *See infra* Part III.A.

79. *See* Procaccia, *Crafting a Corporate Code from Scratch*, *supra* note 7, at 629 (discussing his personal involvement in the drafting process).

A. Background on Israel's Economy[80]

Since the establishment of the State of Israel in 1948, the Israeli economy has been characterized with high growth rates accompanied by high state budget deficit. In the first twenty-four years of its existence, the country absorbed 1.6 million immigrants, multiplied its population by 3.5 and grew at an average annual rate of 8-9%.[81] It is noteworthy that Israel, regardless of the avowed socialist policy that accompanied its founding, was never truly a socialist country in the sense that the government never gained control over the means of production or resisted private entrepreneurship.[82] However, the government did conduct a centralizing policy and was deeply involved in the economy. Owning the vast majority of the land[83] and foreign capital, the Israeli government intervened in the markets through an extensive system of incentives, taxes, quotas, subsidies, appointments, and supervision. The large bureaucracy thereby created often resulted in economic waste, a misallocation of resources, and other vices.[84]

In the years 1973-1985, the Israeli economy went through a severe crisis. At its peak, annual inflation rates reached 500% and the external debt comprised approximately 80% of the GDP.[85] This predicament came to an end in July 1985 with the implementation of the Economic Stabilization Program, whose goals were the reduction of annual inflation rates to 20% to 30%; the stabilization of the balance of payments and the governmental deficit; and the decrease of the

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80. For a formal account of Israel see THE ACCOUNTANT GENERAL, MINISTRY OF FINANCE, STATE OF ISRAEL, PROSPECTUS – 2000 (2000), *available at* http://www.mof.gov.il/prospectus00/mainpage.htm (description is dated as of June 13, 2001 and appears as Exhibit D to the State of Israel's Annual Report on Form 18-K to the U.S. Securities and Exchange Commission for the fiscal year ended Dec. 31, 2000).

81. *See* Sever Plutzker, *The Success: The Growth The Failure – The Deficit*, *in* PERSONS AND DEEDS IN ISRAEL: THE JUBILEE BOOK (Sara & Meir Aharoni eds., 1998).

82. *Id.*

83. According to the official website of the Israel Lands Administration (ILA), 93% (or 5,750,000 acres) of the land in Israel is public domain, being either property of the state, the Jewish National Fund (JNF), or the Development Authority. *See* http://www.mmi.gov.il.

84. *See* Plutzker, *supra* note 81; Gadi Hazak, *Brief History of the Israeli Economy* (2002) (unpublished course presentation, Ben Gurion University, on file with author).

85. *See* Hazak, *supra* note 84.

government involvement in the economy.[86] Following the Stabilization Program, the economy underwent structural changes that enabled it to overcome the preceding crisis. The government, employing a disinflationary policy, gradually pulled out of the markets and encouraged the development of a liberal market economy. The absorption of about one million immigrants from the former Soviet Union during the 1990s coupled with the peace process expedited the sectoral move from agriculture to technology and the exposure to competition.[87] The overall concentration rate of industry, defined by the market share of the three largest factories in each industrial sector, declined between 1990 and 2000 from 33.8% to 28.1%.[88] These processes have led the economy to high but volatile growth rates, restrained inflation rates and external debt, and financial stability.[89]

Despite the gradual privatization of state owned enterprises and deregulation during the last three decades, and especially since the Stabilization Program, government involvement in the Israeli economy is still evident, particularly in the public utilities fields, i.e., electricity, communication, public transportation, shipping, and oil refining.[90] From a comparative perspective, although Israel has increased its economic freedom since 1985, it did so at a slower pace than most other countries

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86. *See id.*

87. *See id.*

88. *See* http://www.cbs.gov.il/hodaot2002/23_02_76t1.htm.

89. *See* Hazak, *supra* note 84; *see generally* Avi Ben Bassat, *The Obstacle Course to a Market Economy in Israel*, *in* THE ISRAELI ECONOMY, 1985-1998: FROM GOVERNMENT INTERVENTION TO MARKET ECONOMICS – ESSAYS IN MEMORY OF PROF. MICHAEL BRUNO 1-48 (Avi Ben Bassat ed., 2001).

90. According to the Official Report of the Government Companies Authority, in 1999, state owned enterprises (not including mixed companies where the state's control is lower than 50%) constituted 7.4% of Israel's export, 2.25% of its employees, 9.47% of the development's investments, and 3.45% of the GDP. *See* THE GOVERNMENT COMPANIES AUTHORITY, THE STATE OF ISRAEL, 1999 REPORT ON THE GOVERNMENT COMPANIES (2000). For the difficulties involved in privatizing the public utilities sector, see Reuben Gronau, *Structural Changes in the Public Utilities Sector in Israel – The Reform that Never was*, *in* THE ISRAELI ECONOMY, 1985-1998: FROM GOVERNMENT INTERVENTION TO MARKET ECONOMICS – ESSAYS IN MEMORY OF PROF. MICHAEL BRUNO 382-431 (Avi Ben Bassat ed., 2001). *See also* Nehemya Shtresler, *The Safe World of the Monopolies*, HA'ARETZ (Tel Aviv), June 5, 2002, at B1 (exemplifying how monopolies and cartels, mostly government owned, are able to raise prices even in times of deep recession in the economy).

with a similar starting point.[91]

A prominent feature of the modern Israeli economy has been the high-tech sector. This sector has its roots in Israel's defense industries, which sprouted even before the establishment of the state of Israel and have developed ever since due to Israel's prolonged security situation.[92] During the 1970s and 1980s, notwithstanding Israel's political and economic turmoil, the high-tech sector kept growing due to the development of the local industry and increasing inward investment by international high tech companies, which recognized the potential and the accelerated expansion of the sector.[93] In the 1990s, the combination of a vast number of skilled immigrants, extensive government support, and political advance situated the high tech sector as a principal exporter, establishing it as the driving force behind the Israeli economy.[94] These years brought about a significant growth in venture capital and start-up companies, backed by foreign investment.[95] This also resulted in dozens of Israeli high-tech firms going public on both the TASE and foreign exchanges.[96] Since mid-2000, however, due to

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91. The reference here is to the semi industrial and most South American countries. *See* Ben Bassat, *supra* note 89, at 35-36.

92. *See* Dan Yachin, *Israel's High Tech Jubilee: 53 (or More) Years of Zionist Start Up Technology*, ISRAEL'S BUSINESS ARENA, May 3, 2001; *How Israeli High-Tech Happened*, GLOBES [ONLINE], Aug. 15, 2000.

93. *Id.*

94. In the years 1990-2000, the share of the Information and Communications Technologies (ICT) in the exports rose from 14.0% to 32.1% and their share in the GDP of the business sector (entire economy) rose from 8.1% (5%) to 18.6% (12.6%). *See* http://www.cbs.gov.il/shnaton53/st18_09.pdf. In 2000, Israel's national expenditure on civilian R&D comprised 4.2% of the GDP, the highest in the world. *See* http://www.cbs.gov.il/shnaton53/st28_15.pdf.

95. Between 1990 and 2000, Israeli venture capital funds raised an overall of $6.5B. *See* Yanay Alfassy, *IVC Online: 3 Times More Venture Capital Raised in 2000 than in 1999*, ISRAEL'S BUSINESS ARENA, Dec. 19, 2000. Annual foreign investment in Israel grew from $0.4B in 1992 to $5.0B in 2000. *See How Israeli High-Tech Happened*, GLOBES [ONLINE], Aug. 15, 2000. In 2000, 513 private Israeli high tech companies raised $3.1B from Israeli venture capital funds and other investors, mostly foreign investment entities. *See* Globes Correspondent, *IVC: Total 2001 VC Investments in Israel Down 36% to $2B*, ISRAEL'S BUSINESS ARENA, Jan. 27, 2002. The Global Competitiveness Report 2000 ranked Israel, with 3,000 start-ups, second behind the U.S. in the number of start-ups and first relative to population. *See How Israeli High-Tech Happened*, GLOBES [ONLINE], Aug. 15, 2000.

96. *See infra* Part II.A.2.

the global crisis in the high tech industry and the deterioration in the security situation in Israel, the local high tech sector has experienced a continuous decline in venture capital investments, massive layoffs, and a sharp fall in the share price of Israeli companies listed on NASDAQ.[97]

Two other relevant characteristics of the Israeli economy are strong labor organizations in most of the non high tech sectors and a strong agriculture lobby that crosses political party boundaries.

According to the 2003 report of the U.S. Department of State, "[t]he country has an advanced industrial economy with a relatively high standard of living."[98] Israel has yet to cope, however, with the rise in economic inequality that manifests itself in increasing disparity in income, as well as the still relatively high government debt and current recession.[99]

A.1. The Israeli Capital Market

Until the mid-1980s, the financial system in Israel lacked competitive traits due to deep governmental involvement in the monetary, capital and foreign currency markets and an oligopolistic structure of the financial intermediaries sector. By controlling the internal and external capital raised, its cost, and allocation, the government, in essence, nationalized the financial markets and brought about a misallocation of resources in the economy. The main instruments used by the government in the context of the capital market were subsidized untradable government bonds that were issued to provident funds, pension funds, insurance companies, and savings plans, as well as "directed" government credit, i.e., subsidized loans that were allocated to selected industries through the banking system.[100]

97. *See* Globes Correspondent, *supra* note 95; Yachin, *supra* note 92.

98. THE BUREAU OF DEMOCRACY, HUMAN RIGHTS, AND LABOR, U.S. DEP'T OF STATE, ISRAEL AND THE OCCUPIED TERRITORIES - COUNTRY REPORTS ON HUMAN RIGHTS PRACTICES - 2003 (2004); *see also* INTERNATIONAL DIVISION, ISRAELI MINISTRY OF FINANCE, THE ISRAELI ECONOMY AT A GLANCE (2001), *available at* http://www.mof.gov.il/beinle/ie/israe_1.htm. For an international comparison of Israel's GDP per capita, see http://147.237.248.51/shnaton54/g28b.pdf.

99. The growth rate of the Israeli economy in 2003 was 1%. *See* http://www.cia.gov/cia/ publications/ factbook/geos/is.html.

100. *See* Oven Yosha & Asher Blass, *The Reform in the Israeli Financial System and the Flow of Funds of Publicly Traded Manufacturing Firms*, in THE ISRAELI

Moreover, the government intervention complicated the markets' structure and reduced the efficacy of monetary policy, thereby contributing to the inflation crisis in the years 1973-1985.[101]

Regarding the banking system, a small number of banks have dominated the Israeli economy from its inception.[102] They have acted as creditors, underwriters, brokers, investment managers, and investors, both directly and through mutual funds and provident funds.[103] This situation has resulted in conflicts of interest, as well as reduced competition.[104] In addition, the exposure in 1983 of a price manipulation scheme in the banks' shares led to the purchase of the majority of these shares by the government.[105] This crisis prepared the ground for the reforms.

In the years following the 1985 Economic Stabilization Program, the government conducted reforms in the different financial markets.[106] With regard to the capital market, the reforms covered two primary aspects: first, relieving institutional investors and banks from the obligation to invest the vast majority of their resources in government bonds, thereby creating a space for private sector companies to enter the capital market; second, reducing the banks' involvement in the financial system through spin-offs, privatization, and divestitures from non-bank

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ECONOMY, 1985-1998: FROM GOVERNMENT INTERVENTION TO MARKET ECONOMICS – ESSAYS IN MEMORY OF PROF. MICHAEL BRUNO 207, 208-09 (Avi Ben Bassat ed., 2001).

101. *See* Ben Bassat, *supra* note 89, at 7-8.

102. Yosha & Blass, *supra* note 100, at 209, state that, in the beginning of the 1990s, nearly three-quarters of the total assets of the banking system were held by the two largest banks ("Hapoalim" and "Leumi") and that the five largest banks controlled 95% of the banking activity.

103. The Israeli law, as opposed to the American Glass-Steagall Act of 1933 (abolished in May 1999), has never separated commercial banks from investment banks. However, a policy of chinese walls is practiced in order to prevent the conveyance of information. *See* Interview with Prof. Meir Het, former Bank Supervisor, in Tel Aviv, Israel (July 1, 2002) (on file with author).

104. For a theoretical explanation and reference to supporting empirical research, see Asher A. Blass, Yishay Yafe & Oved Yosha, *Corporate Governance in an Emerging Market: The Case of Israel*, 10 J. APPLIED. CORP. FIN. 79, 81-82 (1998).

105. For several years the banks manipulated the prices of their shares, which comprised 17% of the public financial assets. Once the manipulation was discovered, the shares' prices collapsed and the government bailed out investors by purchasing their shares, thereby becoming the owner of the banks. *See* Yosha & Blass, *supra* note 100, at 209.

106. For a summary of these reforms, see Ben Bassat, *supra* note 89, at 8-17.

holdings.[107] These reforms substantially changed the financial structure of Israeli companies by facilitating their access to external capital, and invigorated the Israeli stock exchange.[108] They also improved the competitiveness of the securities industry.[109]

However, the reforms have not brought a complete remedy for the drawbacks of the Israeli capital market. First, pension funds are still absent from the capital market arena due to government regulations requiring them to invest between 70% and 93% of their funds in subsidized government bonds. This situation results in a thin capital market, inefficient allocation of resources, and continuous government involvement in the economy.[110] Secondly, a market for non-government bonds never developed despite its necessity.[111] At the end of 2000, low-liquid government bonds dominated about 93% of the bond market.[112]

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107. Following the Brodet Committee recommendations, bank corporations were required to divest from their non-bank holdings so that by the end of 1998 they didn't hold more than 20% of any non-bank entity. *See* THE COMMITTEE FOR EXAMINING THE ASPECTS OF THE BANKS' HOLDINGS IN REAL CORPORATIONS, A REPORT (1995).

108. *See infra* text accompanying notes 124-128.

109. *See* Saul Bronfeld, *The Decrease in the Big Banks' Weight in the Trade of Stocks*, 143 Q. BANKING REV. 69 (1999) (arguing that the decline of the five largest banks' portion in the trade of stocks from 70% in 1992 to 55% in 1999 signifies an increase in the competition in the securities industry); *cf.* Yosha & Blass, *supra* note 100, at 215 (doubting the competitiveness of the commercial banking field).

110. According to Israel's central bank, in 2001, the pension funds, holding 10% of the public financial assets, invested 92.5% of their resources in untradable government bonds. *See* BANK OF ISRAEL, 2001 REPORT – STATISTIC APPENDIX (2002). In 1995, the government decided on a substantial reform in the pension fund area that was based on the principle of actuarial balance. While improving the economic incentive structure for saving, the reform didn't bring about solutions at either the macroeconomic or the microeconomic level. For a review and evaluation of the reform, see Avia Spivak, *The Reform in the Pension Funds*, *in* THE ISRAELI ECONOMY, 1985-1998: FROM GOVERNMENT INTERVENTION TO MARKET ECONOMICS – ESSAYS IN MEMORY OF PROF. MICHAEL BRUNO 257-90 (Avi Ben Bassat ed., 2001); For a description of the concentrated structure of the pension fund area in Israel and the current challenges it faces, see Article Series, *Who will Pay Us the Pension? A Crisis in the Pension Field*, HA'ARETZ (Tel Aviv), May 19-22, 2002.

111. *See* Saul Bronfeld & Kobi Abramov, *The Golden Decade of the Stock Market: Achievements and Misses*, 146 Q. BANKING REV. 26, 36-37 (2001) (asserting that this failure ensued from both technical and regulatory reasons).

112. *Id.*; INTERNATIONAL DIVISION, ISRAELI MINISTRY OF FINANCE, *supra* note 98, at 15. However, the turnover in the bond market has improved during the years 2001 and

Thirdly, the banking system remained highly concentrated.[113] Regardless of the noticeable need to separate the commercial banks from their investment activities in order to reduce market concentration and embedded conflicts of interest,[114] the banks still furnish a variety of services and products to the capital market and maintain their dominance in financing companies, especially through credit instruments.[115] No other financial intermediaries or foreign banks entered the commercial banking field.[116] Moreover, the privatization of the banks in the second half of the 1990s and their forced divestment of non-bank holdings led to the creation of holding companies that control commercial banks.[117]

A.2. The Stock Exchange

Founded in 1935 as the Exchange Bureau for Securities and incorporated in 1953, the TASE acts as the sole exchange in Israel.[118] Among its members are most of the Israeli banks, including Israel's central bank, the Bank of Israel, and major brokerage firms.[119] The TASE members act as brokers and trade securities on behalf of the investors in the TASE.[120] The Securities Law of 1968[121] created the

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2002. *See infra* text accompanying note 150.

113. *See* Ben Bassat, *supra* note 89, at 13 (stating that 2/3 of the overall assets of the banking system are still held by the two largest banks and about 80% are held by the three largest banks, a concentration rate that is among the highest in the western world).

114. *See* THE INVESTIGATION COMMITTEE IN THE MATTER OF THE ADJUSTMENT IN THE BANKS' SHARES, REPORT (1986).

115. *See* Blass et al., *supra* note 104, at 81 (noticing that "the reforms that reduced the government's role as a financial intermediary ended up actually expanding the banks' role in allocating credit and, hence, the extent of their influence."). On the control of the banks in the underwriting market, see Stella Korin-Lieber, *Swallowing Water from the Fear of the Banks*, GLOBES ELECTRONIC ARCHIVE, Mar. 9, 2003.

116. *See* Yosha & Blass, *supra* note 100, at 215-17. In the years 1992-97 the annual expansion rate of the bank credit was larger than the nominal growth in the GDP. *Id.*

117. *See* Zvika Robins, *The Concentration Trend is Exacerbated: 77% of the Stock Market is Held by Control Groups*, GLOBES ELECTRONIC ARCHIVE, Aug. 2, 1999. Note that this state of affairs might change if the recommendations of the Marani Committee to the privatization of Bank Leumi through the stock exchange are implemented. *See* Shlomi Shefer, *Marani Committee: to Restrict the Cross Holdings of the Banks*, HA'ARETZ (Tel Aviv), Aug. 2, 2002, at C2.

118. *See* http://www.tase.co.il/html2/about/overview/history.htm.

119. *See* http://www.tase.co.il/html2/link/members.htm.

120. Currently, no market makers act on the TASE. This situation is expected to

regulatory framework for the operation of the exchange and the companies traded on it.[122] It also constituted the Israel Securities Authority (ISA), an independent regulatory body, whose "function is to protect the affairs of the securities investing public, as determined in the law."[123] The ISA is the Israeli equivalent of the SEC.

Prior to the abovementioned reforms in the capital market, the TASE was small and lacked liquidity. With the improvement in macroeconomic factors in the late 1980s, the removal of the restrictions on investment and finance, and the privatization of state owned enterprises, the annual trading volumes in the TASE increased considerably, as did the relative weight of the stock market in the GDP. Between 1988 and 1993 the annual turnover in the TASE grew tenfold and exceeded $30B. The relative weight of the stock market in the GDP rose from 7% in 1984 to 46% in 1992.[124] At the same time, the change in personnel at the head of the ISA brought about a tremendous improvement in the overseeing of the exchange and the enforcement of securities regulation. Influenced by the American federal securities regulation and the notion of fair disclosure, the Israeli regulator prepared the ground for the development of a modern capital market.[125]

In the decade between 1991 and 2000, the number of companies traded on the TASE rose from 271 to 665 and market capitalization multiplied by 6.[126] At the end of 2000, the total value of the stock

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change in the near future due the adoption of the recommendations of an internal experts committee and the rules implementing these recommendations by the ISA. *See* Yuval Mendelson, *The ISA Adopted the Recommendation of the Hauser Committee for the Regulation of Market Making Activity*, GLOBES ELECTRONIC ARCHIVE, Dec. 22, 2002; http://www.isa.gov.il/news/news.asp?catid=1&id=187&inPage=36&active=pirsum.

121. The Securities Law, 1968, S.C. 234 [hereinafter the Securities Law].

122. For the legislative history of the law, see JOSEPH H. GROSS, THE NEW COMPANIES LAW 3 (2d ed. 2000).

123. *See* http://www.isa.gov.il/english/template/default.asp?catId=1&active=prof.

124. *See* Yosha & Blass, *supra* note 100, at 211.

125. *See* Interviews with Saul Bronfeld, *supra* note 74; Dr. Shimon Wise, Legal Adviser of the ISA 1984-99, in Tel Aviv, Israel (July 31, 2002); Arie Mientkavich, Chairperson of the ISA 1987-97, in Tel Aviv, Israel (Aug. 9, 2002).

126. *See* Bronfeld & Abramov, *supra* note 111, at 27. However, the turnover velocity, i.e., the ratio of the annual turnover to the average shares' value, was volatile during this period and fell behind the accepted level in other stock exchanges around

market reached NIS 270B ($66B) and the total value of the bond market reached NIS 167B ($41B).[127] On the supply side, the privatization of government companies and banks increased the value of companies listed on the stock market between 1991 and 2000 by the total sum of NIS 78B ($19B). On the demand side, two major players entered the TASE: institutional investors, most of which are run by banks, and international investors. By the end of 2000, these investors held 10% and 12%, respectively, of the market value of TASE listed companies.[128] However, the Israeli public is still, to a large extent, absent from the stock market.[129] During this period of time, the percentage of floating assets out of the overall market value of the outstanding shares did not change dramatically and amounted to about 33%, out of which approximately 60% are direct public holdings.[130]

In conjunction with the rise in the supply of and demand for stocks, the TASE itself has gone through a major change. It revisited its trading rules and listing requirements, established a derivative market, strengthened the reporting and capital requirements of its members, adopted a sophisticated trading system that enables automated and continuous trading, reduced its transaction fees and recently launched an online reporting system.[131] During this period of time, the ISA initiated legislation and regulation that enhanced the transparency of traded companies, the independence and expertise of accountants, investment

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the world. *Id.* at 27 n.1. This index pinpoints one of the major problems of the TASE, namely tradability, which will be discussed below. For the World Federation of Exchanges' comparative data regarding turnover velocity, see http://www.world-exchange.org/ publication.TA1601.pdf.

127. *See* Kobi Abramov & Nurit Dror, *The Securities Market in the Year 2000*, 232 THIS MONTH IN THE STOCK EXCHANGE (2000).

128. *See* Bronfeld & Abramov, *supra* note 111, at 30-33.

129. Between 1997 and 2001, the public invested, on average, less than 20% of its financial assets' portfolio in the TASE. *See* BANK OF ISRAEL, *supra* note 110. The reasons for this ostracism vary and probably include preferable high-interest savings alternatives, the global financial crisis, irresponsible investment advising by the banks, and the bad reputation of the Israeli stock market. *See* Merav Arlozerov, *Black Monday, February 7, 1994*, GLOBES ELECTRONIC ARCHIVE, Feb. 9, 1999.

130. Bronfeld & Abramov, *supra* note 111, at 33. The rest of the shares are held by interested parties. For the distribution of the outstanding shares in the years 1997-2001 see BANK OF ISRAEL, *supra* note 110. An interest is defined by the TASE as holding of at least 0.01% of a company's shares.

131. *See* Bronfeld & Abramov, *supra* note 111, at 34-35.

advisers and portfolio managers, and the operation of mutual funds. With an independent investigations department, it substantially remodeled the enforcement of the Securities Law and the supervision of the capital market. In addition, the ISA took it upon itself to regulate some corporate governance issues previously handled by the TASE, such as conflict of interest transactions with control holders, tender offers, and equal voting rights.[132] Following this regulatory revolution, the Israeli capital market purportedly became the world's second most regulated market, lagging only behind its American counterpart.[133]

As for ownership structure, in general, the Israeli marketplace is highly concentrated. According to the data gathered by La Porta, Lopez-de-Silanes, Shleifer & Vishny, at the end of 1995 only 5% of the 20 largest publicly traded firms in Israel were widely held, i.e., did not have any controlling shareholders.[134] Control groups consisting of businesspersons and a small number of families hold large proportions of the stock market.[135] With the flourishing of the TASE at the beginning of the 1990s there was an upsurge in the issue of shares of subsidiaries and affiliated companies and in the purchase of traded

132. The substantive arrangements regarding conflict of interest transactions and tenders offers can now be found in the Companies Law, 1999. However, the regulation of these issues is still given to the ISA.

133. *See* Bronfeld & Abramov, *supra* note 111, at 35-36 (listing the major regulatory innovations that occurred during this period). *See also* Interview with Arie Mientkavich, *supra* note 125 (asserting that the real reform was the conception: the Americanization of the market).

134. Controlling shareholder was defined by the authors as a shareholder whose sum of direct and indirect voting rights exceeds a cutoff of 20%. By comparison, the percentage of widely held firms in the U.K., the United States, and Germany was 100%, 80%, and 50%, respectively. The other 19 largest firms in Israel were controlled by families (50%), the State (40%), and widely held corporations (5%), and in 60% of the cases control was exercised through at least one publicly traded company, a structure known as a pyramid. Moreover, a controlling family controlled, on average, 2.5 firms out of those 20 largest firms. *See* La Porta et al., *Corporate Ownership*, *supra* note 72, at 492, 501.

135. In April 1999, 34 control groups, representing 220 companies, held 77% of the market value. Out of 652 companies listed on the TASE at that time, only 345, encompassing 18% of the market value, were entirely independent. *See* Kobi Abramov & Yuval Zuk, *Control Groups in the Listed Companies*, 214 THIS MONTH IN THE STOCK EXCHANGE 3 (1999). In their calculation, the researchers took into account the total value of controlled companies and the relative value of dominated companies.

companies by other traded companies.[136] Most firms that went public offered 20% or less of their equity in the IPO.[137] These trends increased the concentration of control groups in the stock exchange. The divestment of the banks' non-bank holdings further contributed to the growth of pyramid structures in the market due to the creation of control groups and holding companies, which either control banks or are held by banks.[138] Correspondingly, the privatization of state owned enterprises through the sale of control blocks to strategic investors, most of them existing control holders, did not result in dispersed ownership patterns.[139]

Although in recent years there has been a noticeable decline in the concentration of control groups, due to mergers, tender offers, and sale of companies, they still predominate the market.[140] The same is true with regard to the banks and government holdings.[141] This situation hinders the development of a real market for corporate control in Israel, since the float of the shares of the vast majority of public companies does not suffice for the execution of a takeover. That is, most structural changes taking place in firms listed on the TASE over the last few years did not involve an actual shift of control. Rather, they ensued from internal efficiency considerations, such as removing double headquarters or going private due to low market value, lack of tradability, high

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136. *Id.*

137. Blass et al., *supra* note 104, at 86. The listing of hundreds of medium-size and small companies, some of them also known as "bubble companies", and the sharp rise in the market value in the years 1992-93 were followed by a crash of the stock market in February 1994. *See* Bronfeld & Abramov, *supra* note 111, at 29, 37-38. For the implications of this crisis see Arlozerov, *supra* note 129.

138. Blass et al., *supra* note 104, at 81 (noting the banks' "dominant role [of] all facets of the of the capital market"); Robins, *supra* note 117.

139. Blass et al., *supra* note 104, at 85 (noting that the privatization process has not been conducive to increasing the role of institutional shareholders other than "bank-managed" funds).

140. By June 2002, 30 control groups, representing 214 companies, held 65% of the market value. *See* Kobi Abramov & Yuval Zuk, *A Decrease in the Concentration of Control Groups in the Listed Companies*, 251 THIS MONTH IN THE STOCK EXCHANGE (2002).

141. The overall market share of the five largest banking groups declined from 20% in 1999 to 19% in 2001. The market share of government and mixed companies decreased from 15% in 1999 to 11% in 2001. This decline has not affected the ranking of the government as the second largest control holder in the TASE. *Id.*

maintenance cost, and the inability to raise capital.[142] In practice, transfers of control are being made outside of the stock exchange.

Another feature of the Israeli stock market is private placements. These have dominated the primary market since 1999, comprising 60% to 80% of the capital raised between 1999 and 2002.[143] At the end of 2002, the TASE board removed a minimal float requirement to promote private placements.[144] Although private placements are cheaper and faster than public offers, possibly assisting companies to raise capital in times when the economy is performing poorly, they also come with a price. The shares sold in a private placement are blocked and are not resalable for a period of time.[145]

Despite the significant facilitation and improvement of the trading system and of the supervision and regulation of the exchange by the TASE and the ISA, the stock market characteristics mentioned above result in a reduction in trading volume and number of traders, discourage diversified portfolios, and increase volatility, thereby causing the Israeli market to lag behind other developed capital markets.[146]

From the last quarter of 2000 until February 2003, the activity in the TASE slowed down due to the political situation, the economic recession, and the falls in NASDAQ.[147] The daily turnover decreased

142. *See id.*; Shay Shalev, *A Wave of Tender Offers: 48 Companies were Delisted in the Last Two Years*, GLOBES ELECTRONIC ARCHIVE, Nov. 25, 2002.

143. *See* Nurit Dror, *An Increase in the Private Placements in the Stock Exchange – 1990 to 2002*, THIS MONTH IN THE STOCK EXCHANGE, 255 (2002).

144. *See id.* Prior to its revocation, the minimal float requirement was a condition to effecting a private placement.

145. *Id.* According to the Securities Law and its regulations, a private placement requires a preliminary approval of an exchange for the listing of the offered securities. The length of the blocking period varies with the type of the offeree. It is noteworthy that, in order to encourage companies to raise funds in the capital market, the ISA recently recommended to curtail the blocking periods that apply to private placements. *See* Globes Service, *The ISA Shortens the Blocking Period for Sophisticated Investors who Hold Securities that were Issued Without a Prospectus*, GLOBES ELECTRONIC ARCHIVE, March 23, 2003.

146. *See* Abramov & Zuk., *supra* note 135; Arlozerov, *supra* note 129; Yaron Friedman, *Try to Sell in the Stock Exchange, Not Sure You will Succeed*, GLOBES ELECTRONIC ARCHIVE, March 6, 2003.

147. At the end of 2001, the market capitalization of the 649 firms listed on the TASE was equal to NIS 275B ($58.5B). By 2002, these numbers deteriorated to 625 firms and market capitalization of NIS 215 ($46B). *See* THE TASE, 4 THE BOURSE

and the trading concentration grew significantly.[148] Foreign investors withdrew their investments, and their market share, representing mostly interested parties, declined by the end of 2001 to 10%.[149] The crisis in the financial markets revitalized the bond market and in 2001, for the first time, its turnover exceeded that of the stock market.[150] During 2003, as a result of the receiving of U.S. loan guarantees and improvements in the economy, there was a sharp rise in stock prices and trading volume in the TASE.[151] Taking advantage of the rise in stock prices and trading volume, control holders and interested parties sold large quantities of their shares, causing the holdings of the public to reach a peak of 47% of the market value.[152] During this time there was

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(2002).

148. The average daily turnover in the years 2000-02 was NIS 514B ($109B), NIS 293B ($62B), and NIS 243B ($52B), respectively. In 2000, the overall turnover in the Tel Aviv-25 stocks, the 25 stocks with the highest market value, comprised 57% of total market turnover. By 2001, it was equal to 73%, and by 2002 to 76%. *See* Nurit Dror, *The Securities Market in the Year 2001 – An Annual Survey*, 244 THIS MONTH IN THE STOCK EXCHANGE (2001); THE TASE, *supra* note 147. Similarly, the share of the 20 most traded stocks, not all of them necessarily included in the Tel Aviv-25 Index, rose from 55%-60% in the years 1997-2000 to 74% in 2001, and to 74.5% in 2002. *See* Kobi Abramov, *An Increase in the Trade Concentration in the Stock Exchange in Tel Aviv*, 244 THIS MONTH IN THE STOCK EXCHANGE (2001); THE TASE, *supra* note 147. For the World Federation of Exchanges' comparative data regarding average daily turnover and trading concentration, see http://www.world-exchanges.org.

149. *See* Dror, *supra* note 148.

150. In 2001 and 2002, the average daily turnover in the bond market was NIS 595B ($127B) and NIS 766B ($163B), respectively. The issuance of non-government bonds by the business sector rose sharply and equaled NIS 2.9B ($0.6B) in 2001 and NIS 4.7B ($1B) in 2002. At the same time, however, the net amount raised by government bonds climbed from NIS -8.5B ($-1.8B) in 2000 to NIS 13B ($2.8B) in 2001 and NIS 25B ($5.3B) in 2002. *See* THE TASE, *supra* note 147.

151. At the end of 2003, the market capitalization of the 577 firms listed on the TASE was equal to NIS 300B ($68B) and the stock index increased by 50% compared to 2002. The average daily turnover for that year was NIS 350B ($80B) and the share of the 20 most traded stocks decreased to 68% of total market turnover. *See* ANNUAL SURVEY 2003, 15 THE BOURSE (2003). Notice that although about 50 firms were delisted from the TASE during 2003, their delisting was not detrimental to the capital market since most of them were delisted due to tender offers which eliminated pyramid structures or very small firms in which the public holding was less than minimal. *See* KOBI ABRAMOV, DELISTING OF PUBLIC COMPANIES BY TENDER OFFERS IN THE YEAR 2003 (2004), *available at* http://www.tase.co.il/portal/pdf/pdf-m/83872.pdf.

152. *See* KOBI ABRAMOV, INTEREST PARTIES' SALES JUMPED UP THE PUBLIC

also a decline in the supply of government bonds, which enabled the business sector to substantially increase the issuance of non-government bonds.[153]

A pivotal phenomenon that should be mentioned here is the listing of numerous Israeli companies on foreign exchanges, most noticeably on NASDAQ.[154] In the years 1990-96, 56 Israeli companies, most of them high tech oriented, issued stock in the United States, raising about $1B.[155] Since then, their number almost doubled, making Israel the second largest foreign issuer in the United States, after Canada.[156] In the year 2002, there were 100 Israeli companies listed in the United States and 30 companies listed in Europe.[157] As opposed to the concentrated ownership that characterizes the TASE, the ownership of the Israeli firms listed on foreign exchanges is fairly dispersed.[158] What is interesting and unique about Israeli companies listed abroad is that most of them are not listed on the TASE.[159] That is, they trade exclusively on

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HOLDINGS IN THE YEAR 2003 (2004), *available at* http://www.tase.co.il/portal/pdf/pdf-m/82719.pdf. Note, however, that in only 23 firms, 14 of which are dually listed on the TASE and in the U.S., the public holding exceeded 50%. *Id.*

153. In 2003, the government issued bonds in the amount (net) of NIS 20B ($4.6B), and the business sector issued non-government bonds in the amount of NIS 5.9B ($1.3B), which represents a 25% increase compared to 2002. *See* ANNUAL SURVEY 2003, *supra* note 151.

154. For an overview, see Edward B. Rock, *Greenhorns, Yankees, and Cosmopolitans: Venture Capital, IPOs, Foreign Firms, and U.S. Markets*, 2 THEORETICAL INQUIRIES L. 711 (2001).

155. *See* Asher Blass & Yishay Yafeh, *Vagabond Shoes Longing to Stray: Why Foreign Firms List in the United States*, 25 J. BANKING & FIN. 555 (2001).

156. In 2000 alone, Israeli companies raised $4.2 billion, mostly on NASDAQ, although $800 million were raised on European exchanges. *See How Israeli High-Tech Happened*, GLOBES [ONLINE] (Aug. 15, 2000) *at* http://www.globes.co.il/serveen/globes/docview.asp?did=258771&fid=954.

157. Telephone Interview with Kobi Abramov, Director of the Research Department, the TASE (July 22, 2002) (on file with author).

158. In the years 1996-2001, interested parties held, on average, 8.7% of the Israeli Companies listed abroad. *See* BANK OF ISRAEL, *supra* note 110.

159. Prior to October 2000, when mitigating regulations regarding dual listing came into force, only 15 of the companies listed on foreign exchanges were listed also on the TASE. These companies usually listed on the TASE first and only later raised money in the U.S. *See* Shlomo Grinberg, *Everything is Talking*, GLOBES ELECTRONIC ARCHIVE, Sept. 27, 2000.

a foreign exchange.[160] Some of these companies even incorporated in the United States.[161]

Several explanations have been suggested to explain this trend.[162] One explanation is that the migration of Israeli firms to NASDAQ ensued from the collapse of the TASE in 1994,[163] which extinguished it as a plausible exit option at a critical moment in the development of Israeli venture capital.[164] Once NASDAQ was established as the preferred IPO exit market for Israeli firms, going public in a less salient market, such as the TASE, might have sent a negative signal to investors.[165] A related theory, which is supported by empirical research, is that there exists "a separating equilibrium, whereby high-quality IPOs opt for U.S. equity markets, while less-promising firms remain in local markets, and this is not necessarily a result of disclosure requirements".[166] This claim is based on the notion that the Israeli bank-based financial system is less apt than the American market-based system to finance innovative firms, due to its embedded corporate governance deficiencies.[167] A third reason given for the lack of dual

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160. Blass & Yafeh, *supra* note 155, at 556.

161. *See* Bronfeld & Abramov, *supra* note 111, at 38-39. These companies are "Israeli" only to the extent that they usually have an Israeli subsidiary or their R&D center is located in Israel. On the implications of the choice to incorporate in the U.S., see Rock, *supra* note 154, at 736-42 (suggesting that "foreign listing may reduce barriers to foreign investors or improve [a] firm's reputation in foreign markets").

162. Note that the rationales for exclusive listing on a foreign exchange are distinguished from those offered to explain the more common phenomenon of dual listing. For a critical discussion of the latter, see Amir N. Licht, *Cross-Listing and Corporate Governance: Bonding or Avoiding?*, 4 CHI. J. INT'L L. 141 (2003).

163. *See supra* note 137.

164. *See* Edward B. Rock, *Coming to America? Venture Capital, Corporate Identity, and U.S. Securities Law*, at 8 (Feb. 7, 2002) (Research paper, U. of Penn., Inst. For Law & Econ.); Amir N. Licht, *Managerial Opportunism and Foreign Listing: Some Direct Evidence*, 22 U. PA. J. INT'L ECON. L. 325, 336-37 (2001).

165. *See* Rock, *supra* note 164, at 6-8 (arguing that after NASDAQ established prominence in trading Israeli securities "the choice to go public" in another market might create the impression that the issuers are sub-standard unless they offer a "convincing explanation" for their choice).

166. Blass & Yafeh, *supra* note 155, at 570 (potential benefits related to listing in the U.S. include investor recognition and recognition among potential clients).

167. *See id.* at 558-59; Blass et al., *supra* note 104, at 80 (asserting that "it seems plausible that U.S. and other foreign portfolio investors have shied away from the Israeli stock market and chosen Israeli companies listed on the NASDAQ in order to

listing is the effort made by some of the companies to conceal their Israeli identity.[168] The most popular argument, however, is that the burdensome regulation of the stock exchange, the enactment of the new corporate law, and mainly tax disincentives deter Israeli companies listed on foreign exchanges from listing their stocks also on the TASE.[169]

In order to invigorate the Israeli stock exchange, in 2000, the Knesset (the Israeli parliament) after years of debate passed an amendment to the Securities Law that alleviated the listing requirements on the TASE of companies listed on foreign exchanges.[170] Since October 2000, when the legislation became effective, twenty-one companies already listed on American exchanges were listed on the TASE.[171] Additionally, the implementation of an overall tax reform in Israel in January 2003 has reduced the tax distortions regarding companies that are incorporated outside of Israel.[172]

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avoid corporate governance problems associated with the TASE").

168. *See* Interview with Saul Bronfeld, *supra* note 74; Zvika Robins, *Tel Aviv – New York – Tel Aviv*, GLOBES ELECTRONIC ARCHIVE, July 27, 2002.

169. *See* Bronfeld & Abramov, *supra* note 111, at 38-39 (stating that the Israeli Companies traded on the NASDAQ refused to bear the "double regulation" – Israeli supervision in addition to the U.S. one); Grinberg, *supra* note 159. *Cf.* Licht, *supra* note 164, at 346 (arguing that "[b]y listing, and remaining listed, only in the American market officers and controlling persons of Israeli issuers were able to take advantage of its more lenient disclosure regime").

170. *See* The Securities Law (Amendment No. 21), 5760-2000. The law currently applies only to companies listed on the NYSE, AMEX, and NASDAQ-NM. For the backdrop against which the amendment was enacted and the different views on the issue, see Licht, *supra* note 164; Stella Korin-Lieber, *Exactly like America*, GLOBES ELECTRONIC ARCHIVE, Feb. 20, 2000. Recently, the ISA further relieved the reporting requirements for these companies in order to encourage the Israeli primary market. *See* http://www.isa.gov.il/news/news.asp?ID=207&inPage=9&active=pirsum.

171. *See* ANNUAL SURVEY 2003, *supra* note 151. At the end of 2001, the market share of these companies (than only 15) constituted 5.5% of the stock market. *See* Dror, *supra* note 148. In the last quarter of 2003, the average daily turnover in the new dual stocks was NIS 26.5B ($6B), in comparison with NIS 10B ($2.3B) in 2002 and in the first three quarters of 2003. *See* KOBI ABRAMOV & NURIT DROR, A SHARP RISE IN THE TRADING VOLUMES IN THE NEW DUAL STOCKS AT THE END OF THE YEAR 2003 (2004), *available at* http://www.tase.co.il/portal/pdf/pdf-m/82268.pdf.

172. As part of the reform it was suggested to exempt these companies from income and capital gains tax resulting from the transfer of their activities or assets to companies incorporated in Israel. In conjunction with the general decrease in capital gains tax, this

B. The Political History of the New Corporate Law

The need to reform Israel's corporate law has been long established. It was occasioned by two main factors.[173] First, largely based on the English Act of 1929, the Companies Ordinance[174] was anachronistic and did not fit modern reality.[175] Second, focused on procedure, the Ordinance left the development of the substantive corporate law almost exclusively to the courts.[176] This need for reform produced various initiatives, which were, at least in part, translated into several amendments but did not result in an overall reform until the recent enactment of the new law.[177]

The new Israeli corporate law came into force as of February 2000, replacing the Companies Ordinance.[178] The legislative process of the new law lasted eighteen years. It began in 1982 with the Minister of Justice's application to Professor Uriel Procaccia of the Law Faculty of the Hebrew University of Jerusalem, asking him to draft a new and cohesive corporate code to replace the existing Ordinance.[179] It continued in 1985 with a public committee, chaired by then Supreme Court Justice Aharon Barak, basing its work on Professor Procaccia's proposal.[180] The report of the Barak Committee, submitted in 1994, was endorsed by the government and later by the Knesset, which referred it

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policy is intended to encourage entrepreneurs to incorporate their companies in Israel. *See* BARUCH LEVI, THE KNESSET - CENTER FOR INFORMATION AND RESEARCH, THE EFFECT OF THE TAX REFORM ON THE HIGH TECH SECTOR (2002), *available at* http://www.knesset.gov.il/mmm/doc.asp?doc=m00271&type=pdf.

173. *See* BARAK COMMITTEE REPORT, *supra* note 8, at 4-5.

174. The Companies Ordinance [New Version], 5743-1983, Nosah Hadash [Israel's New Version Lawbook] 716 [hereinafter the Companies Ordinance or the Ordinance].

175. *See* BARAK COMMITTEE REPORT, *supra* note 8, at 4-5.

176. *Id.*

177. *See* Appendix A for the main amendments in the Israeli corporate law and the legislative process of the Companies Law, 1999. It is worth mentioning, in this context, the enactment of the Securities Law and the Government Companies Law, 1975, S.C.132 [hereinafter the Government Companies Law]. For an overview of the different initiatives, see GROSS, *supra* note 122, at 1-4; BARAK COMMITTEE REPORT, *supra* note 8, at 6-8.

178. However, the new law does not concern bonds, liens, and dissolution. These matters are still regulated by the Ordinance. *See* § 367 of the Companies Law, 1999.

179. *See* PROCACCIA, *supra* note 7; Procaccia, *supra* note 7.

180. *See* BARAK COMMITTEE REPORT, *supra* note 8.

to a parliamentary legislative committee.[181] The Knesset passed the Companies Law in 1999.[182] But the process did not end there. It continued in a parliamentary subcommittee that discussed the law's regulations with respect to issues that were delegated to the Minister of Justice and a bill amending the newly enacted law.[183]

The philosophy underlying the new Israeli law, according to its official written explanation, is the autonomy of private will.[184] Put differently, the law assumes the existence of a free and fair marketplace and interferes only when there is perceived to be a specific market failure.

The law's loudest critics argue that, notwithstanding its declared goal, the new law throws a wrench into the wheels of the free market by over-regulating and encumbering the regular business operation of corporations.[185] These critics, mostly representative of the industrial sector and the high-tech industry, further claim that Israel would have been better off adopting the Delaware General Corporation Law.[186] On the other end of the spectrum, some academics argue that by ignoring Israel's idiosyncratic characteristics, such as the centralized capital market and the unspecialized court system, the new law puts misplaced reliance on the presumption of market efficiency as the ultimate

181. *See* The Companies Bill, 1995 H.H., 2 [hereinafter the Companies Bill, 1995].

182. *See* Companies Law, 1999.

183. *See* The Companies Law (Amendment No. 3), 2005, S.C. 238 [hereinafter the Companies Law (Amendment No. 3)]. For the official explanation relating to the amending law, see The Companies Bill (Amendment), 2002 H.H., 638 [hereinafter the Companies Bill (Amendment), 2002] and the Companies Bill (Amendment No. 3) (Qualification of Outside Directors), 2004 H.H.K., 4 [hereinafter the Companies Bill (Qualification of Outside Directors 2004)].

184. The Companies Bill, 1995, at 6.

185. *See* Omri Yadlin, *Corporate Law as a Product*, 1 SHA'AREI MISHPAT 267 (1998) (Dr. Yadlin represented the Manufacturers' Association of Israel in the Parliamentary Subcommittee meetings.); *The Organization Representing Stock-Exchange Firms Fears the New Corporate Law*, GLOBES ELECTRONIC ARCHIVE, Oct. 12, 1997; *Managers Against the Corporate Law*, GLOBES ELECTRONIC ARCHIVE, July 7, 1999.

186. *See* Zvi Lavi & Orna Raviv, *Muzi Verthime: Does the Justice* Ministry *Seek to Drive the Private Companies to the Stock Exchange or Abroad?* GLOBES ELECTRONIC ARCHIVE, March 26, 1997; Stella Korin-Lieber, *The Jewish Head Invents Patents*, GLOBES ELECTRONIC ARCHIVE, Dec. 23, 1999; Moran Bar Cohva & Hadas Magen, *Her Hand is Everywhere*, GLOBES ELECTRONIC ARCHIVE, Dec. 26, 2000.

guarantor of investor rights.[187] According to this view, to the extent that the large concentration of ownership and the Israeli market's deficiencies work to the detriment of small and unsophisticated investors, a corporate law that assumes the existence of an efficient market and judicial mechanisms heightens this effect.

These divergent reactions raise questions regarding the influence exerted by different groups interested in the substance of corporate law on the output of the legislative process. Who are these groups? In what stage of the legislative process did they become involved? Were they able to affect the outcomes of the process? And if so, in what respect and to what extent?

In order to start answering these questions, this paper traces the work of the different bodies that participated in the legislative process: Professor Procaccia's elaborated proposal, the public committee's discussions that resulted in a bill, and the parliamentary committee's deliberations that created the law's final version. Using the committees' minutes and formal protocols, as well as memoranda, newspaper articles, and interviews with prominent figures involved in the process, this paper aspires to portray a more complete picture of the legislative process and to advance the understanding of its political aspects. What follows, thus, is the story of the enactment of the new law.[188]

B.1. Professor Procaccia's Proposal

As mentioned above, the legislative process of the new corporate law began in 1982 with Professor Procaccia's commission by then Minister of Justice Moshe Nissim.[189] That was not, however, the first time in which a corporate law professor had been asked to prepare a draft for a new corporate code to replace the Companies Ordinance.

187. *See* Zohar Goshen, *A Critical Look at the New Companies Law: Corporate Goal, Takeovers, and Class Actions*, 32 MISHPATIM 381 (2002); Uriel Procaccia, *Behind the Scenes*, 32 MISHPATIM 303 (2002). For a discussion of Israel's distinctive characteristics that may necessitate mandatory interference, see Goshen, *supra* note 77.

188. This section of the paper is mainly based on a series of interviews conducted in the summer of 2002 with key participants in the legislative process. For the full list of interviews and meetings, see Appendix B.

189. *See* PROCACCIA, *supra* note 7, at 1; Procaccia, *supra* note 7, at 629. The commission was professional, in concurrence with the then Attorney General, and later Supreme Court Justice, Prof. Isaac Zamir, and did not ensue from a political party affiliation.

Two earlier initiatives did not result in legislation.[190] This practice of involving academics in the legislative process through drafting preliminary proposals and/or working side by side with an appointed public committee appears to be a common practice in legislating extended codices in Israel.[191]

The appointment letter of Professor Procaccia, if one existed, did not include any specific directions regarding the contents of the proposal or its structure. The only request the Justice Ministry made to Professor Procaccia was that he would not settle for general principles but rather submit a tentative draft.[192] Professor Procaccia toiled on his proposal from 1982 to 1985.[193] Whenever he finished writing a chapter, he would send a timely draft to a wide correspondent list that included, among others, the Israeli Bar, the Institute of Certified Public Accountants, the Manufacturers' Association, the Banks' Association, and the Histadrut, the largest workers' union in Israel, in order to receive their comments. The responses were few. This tepid response might be explained by the fact that these organizations believed that Professor Procaccia's work would not result in legislation or that it would take a long time for it to be realized.[194] Moreover, some of the groups that were later involved in the process, such as the Association of Publicly Traded Companies, did not even exist at the time when Professor Procaccia wrote his proposal.

B.2. The Barak Committee

In 1985, after Professor Procaccia completed his proposal, a public committee headed by Justice Aharon Barak commenced its work.[195] The

190. *See* BARAK COMMITTEE REPORT, *supra* note 8, at 6-8 (discussing the proposals submitted by the late Professor Igal Yadin in 1957 and by Professor Aharon Barak in 1975. The former initiative was adopted by the Justice Ministry but never ripened into legislation. The latter was cut off due to the appointment of Professor Barak as Attorney General.).

191. For example, in the case of the codification of the civil law, the public committee, also Chaired by Justice Aharon Barak, has been assisted by Professor Miguel Deutch of Tel Aviv University Faculty of Law.

192. *See* Interview with Prof. Uriel Procaccia, the Hebrew University of Jerusalem Faculty of Law, in Jerusalem, Israel (July 29, 2002) (on file with author).

193. *Id.*

194. *Id.*

195. Originally, the late Justice Isaac Kahan, retired Chief Justice of the Supreme

idea was to create a professional committee that would create the best corporate law for the State of Israel. According to the brief letter of appointment, the Committee's task was to discuss the work of Professor Procaccia. No other terms of reference were set in the letter.[196] Aware of the failure of former initiatives, it seems that quite from the beginning the Committee took it upon itself to create a quasi-statutory draft rather than settling for a mere recommending explanatory format. This approach was manifested in the Committee's agenda and final account.[197] Professor Procaccia usually opened the Committee meetings with a presentation of the relevant topic, followed by an explanation of the suggested legal provisions by the committee organizers. The participants then entered into a prolonged discussion, whose resolutions were later compiled by the committee organizers. The final report of the Committee includes a detailed proposal, drafted as a bill.

Formally, the Barak Committee comprised seven members, among whom only one was a government official,[198] though experts and interested parties were invited to the Committee meetings. Specifically, Justice Ministry officials, the Head and the Legal Advisor of the ISA, the Chairperson and the Managing Director of the TASE, and the Legal Advisor of the Bank of Israel attended the Committee meetings on a regular basis.[199] Due to the working method of the Committee, discussed below, all the participants, not merely the formal members,

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Court, was appointed to chair the committee, but he passed away before the committee convened. Justice Barak, who was a member of the committee, agreed to take his place as the chairperson of the committee.

196. *See* Letter from Moshe Nissim, Minister of Justice, to Members of the Committee (Feb. 12, 1985) (on file with author).

197. *See* BARAK COMMITTEE REPORT *supra* note 8.

198. The reference here is to the General Manager of the Justice Ministry, Meir Gabay. The other members of the committee were: Prof. Joseph H. Gross of Tel Aviv University Faculty of Law, who is also a practitioner; Amihud Ben-Porat, a practitioner and a former chairperson of the Bar committee for corporate law legislation; the late Dr. Eliyahu Lahovski, the legal advisor of the Jewish Agency; Prof. Meir Het, the Chairperson of the TASE at the time of the appointment and later the Chairperson of Bank Leumi; and Zeev Sher, then the Legal Adviser of Bank Leumi. The latter two are former public servants and were appointed at the request (but not on behalf) of the TASE and the Banks' Association. *See* GROSS, *supra* note 122, at 4 n.28.

199. *See* BARAK COMMITTEE REPORT, *supra* note 8, at 1-3. Other participants were the Companies Registrar, and the Trademark Registrar. *See* THE JUSTICE MINISTRY, THE COMMITTEE FOR THE PREPARATION OF A NEW COMPANIES LAW, A MEETING PROTOCOL (Jan. 29, 1986) (on file with author).

took part in the Committee's output.

The work of the Barak Committee lasted nine years, during which the Committee convened more than fifty times.[200] The meetings were held approximately once a month. The discussions in the Committee were of a highly intellectual nature. Some referred to them as an extended course in corporate law. There were no hearings in the accepted meaning of the term.[201] The Committee invited a few external experts to express their opinions before but most meetings were held in the forum of the Committee members and abovementioned participants.[202] Other interested parties, such as the Manufacturers' Association or the Banks' Association, were not invited to give oral presentations before the Committee but had an opportunity to comment on the Committee's working drafts in writing.[203] They also met formally and informally with the representatives of the Justice Ministry and the ISA. There was not, however, any real continuous dialogue with those groups.

As for decision-making, there were no votes. Rather, decisions were accepted by persuasion and compromise that led to unanimity.[204] As was later described by Professor Procaccia:

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200. *See* BARAK COMMITTEE REPORT, *supra* note 8, at 1-3. Only on the matter of takeovers has the Barak Committee heard from international experts, such as Professors Louis Loss and Lucian Bebchuk of Harvard, Professor Jim Gower of London, and Professor Yaakov Amihud of Tel Aviv University and NYU. *See* GROSS, *supra* note 122, at 368 n.13.

201. That is, "[i]n legislative practice, any proceeding in which legislators or their designees receive testimony about legislation that might be enacted". *See* BLACK'S LAW DICTIONARY 725 (Bryan A. Garner ed., 7th ed. 1999).

202. In this context it is worth mentioning that on its third meeting the committee decided not to divide its work among subcommittees but to sit in plenum. *See* THE JUSTICE MINISTRY, THE COMMITTEE FOR THE PREPARATION OF A NEW COMPANIES LAW, A MEETING PROTOCOL (Nov. 5, 1985) at 1 (on file with author).

203. *See* Interview with Judge Michal Agmon-Gonen, organizer of the Barak Committee and Justice Ministry representative to the parliamentary committee, in Jerusalem, Israel (July 29, 2002) (on file with author).

204. Only three specific reservations were noted in the committee's § 420 proposal. These were added by Professor Gross just prior to the submission of the final draft of the committee's report to the Minister of Justice. legislation. *See* Interview with Michel Ohayon, the Israeli Bar, in Tel Aviv, Israel (July 23, Aug. 12, 2002) (on file with author).

> In the Barak Committee votes never took place. Disputed matters – and there were plenty of those – usually were not decided on the spot, and their resolution was postponed to a later time. When the later time arrived, the dispute was long forgotten, or the members were exhausted discussing it, or the matter was postponed once again. In the end consensus was achieved on all issues, despite the severe disagreements among the members . . . .[205]

The Committee's deliberations were not formal. Votes were not cast. All participants, regardless of their designated status, received the opportunity to express their views, and no practical distinction existed between formal members of the Barak Committee and other participants. Essentially, if not formally, the latter were part of the Committee.[206]

The organizers of the Barak Committee were representatives of the Justice Ministry.[207] They distributed the preliminary materials, summarized the Committee meetings,[208] conducted additional research, kept contact with interest groups, and drafted the Committee's final report. Their work went well beyond procedure and had a significant effect on the report's contents. Indeed, one of the conspicuous attributes of Procaccia's proposal and the Barak Committee is that they coordinated with the Justice Ministry for the whole way.[209] In addition, the Barak Committee Report was specific enough to be presented as a statutory draft. These two qualifications, taken together with the reputation of the Committee members, made it possible for the Barak Committee Report to be adopted by the Ministers' Committee for

205. Procaccia, *supra* note 187, at 305 (translated freely by author).

206. *See* Interview with Prof. Uriel Procaccia, *supra* note 192.

207. *See* Bar Cohva & Magen, *supra* note 186; THE COMPANIES BILL, 1999 (SECOND READING AND THIRD READING) (NO. 287), D.K. (1999). The person who is identified most with the legislative process of the new law is Davida Lahman-Messer, Deputy Attorney General, who organized the work of the Barak Committee and later accompanied the parliamentary committee' deliberations. Other representatives of the Justice Ministry who took part in the process were Michal Agmon and later Eran Rosman.

208. For the most part, the Barak committee's protocols consist of digests rather than a word for word documentation.

209. For instance, in the introduction of his book, Professor Procaccia thanks Professor Isaac Zamir, the Attorney General at the period during which the monograph was written, for his aid in preventing opposing legislative initiatives. *See* PROCACCIA, *supra* note 7, at 3.

Legislation in about three hours.[210] The next stage was the Knesset.

Prior to discussing the parliamentary proceedings, a few words on public advisory committees in Israel are apropos.[211] The use of advisory committees in democratic countries has become a common practice in the twentieth century.[212] In Israel, at least 424 committees were appointed between the years 1948 and 1980.[213] These committees have been appointed either on a permanent basis or ad hoc, and have usually been assigned with one of six main tasks: studying and discussing important policy matters; examining procedural proceedings with respect to the implementation of laws; investigation committees; nominations committees; arbitration; or researching into subjects that require professional expertise (e.g., airplane crashes).[214] Whereas the authority, structure, and activity patterns of permanent committees were set in the authorizing statute, no such rules or guidelines were set with regard to ad hoc committees.

A study of ad hoc committees commissioned by the Ministry of Finance and Ministry of Interior in the years 1970-79 identified several characteristics of public advisory committees in Israel:[215] a committee usually submits its report within one to two years; it typically consists of five to eight members, about half of whom are public representatives; decisions are usually reached through compromise and consensus; and the supporting staff is seldom independent of the appointed ministry. As for the chairperson, whereas most committees appointed by the Ministry of Finance were chaired by an independent public figure, Ministry of Interior officials chaired most committees appointed by that ministry. Finally, from a closer scrutiny of the differences between the committees appointed by the two ministries, the researchers reasoned

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210. *See* Interview with Judge Michal Agmon-Gonen, *supra* note 203.

211. There has been little research on public advisory committees in Israel. A relevant exception is: Ehud Harari & Menachem Hofnung, *Advisory Committees for Policy Making in Israel in a Comparative Perspective*, 28-29 MEDINA, MIMSHAL VIHASIM BENLEUMIYIM 39 (1988).

212. *See id.* at 39-40. For a list of references regarding research on the subject in France, the United States, Sweden, Holland, Australia, Japan, and Denmark, see *id.* at 45.

213. *Id.* at 45-47.

214. *Id.* at 41-42.

215. *See id.* at 47-64. To the best of my knowledge, no later empirical work on public advisory committees in Israel exists.

that the committees' instrumental functions varied.[216] Whereas the roles of Ministry of Finance committees were, first, the direction of policy, and second, the incorporation of interest groups into policy making, the roles of the Ministry of Interior's committees were mainly legitimizing the policy adopted by the ministry and developing cooperation with different groups whose support was required for the implementation of the committee's recommendations.[217]

In view of these findings the authors concluded that evaluating the contribution of public advisory committees according to the question of whether their recommendations were implemented or not, is a common mistake. This is so because the raising of new ideas in itself creates a public discourse and openness that are crucial to policy making.[218] Nevertheless, it would be proper to note that there are numerous committees' reports that were never implemented, even more so when it comes to overall reforms.[219]

Considering the attributes of the Barak Committee in light of the aforementioned characteristics might lead to three conclusions. First, the length of time the Barak Committee spent is extraordinary. There are several reasons why it took the Committee nine years to complete its work. The task the Committee undertook was gigantic.[220] The Committee did not settle for partial or limited revisions of the existing Ordinance but aimed at writing a brand new corporate law from scratch.[221] Its work, therefore, was much more extended than that of

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216. Harari & Hofnung defined three possible instrumental roles of public advisory committees: policy directing, i.e., providing the ministry with guidelines on a certain issue; legitimizing the action or the inaction of the ministry; and the incorporation of interest groups in order to give them representation in policy making processes, as well as to encourage their support in the implementation of the committee's recommendations. *See id.* at 42.

217. *See id.* at 59-64.

218. *See id.* at 65-67.

219. *See* Interviews with Saul Bronfeld, *supra* note 74; Arie Mientkavich, *supra* note 125. *See also* GROSS, *supra* note 122, at 2-3; BARAK COMMITTEE REPORT, *supra* note 8, at 6-7, for the futility of former public committees in amending Israeli corporate law.

220. The Companies Law, 1999 is one of the longest statutes on the Israeli lawbook. It consists of 378 sections. The committee's proposal consists of 420 sections.

221. *See* BARAK COMMITTEE REPORT, *supra* note 8, at 8-9; Procaccia, *supra* note 7, at 629-32. However, due to time constraints and overlapping with the Insolvency Law Committee, the law does not concern bonds, liens, or dissolution.

most other advisory committees.[222] The intellectual disposition of the meetings and their informal conduct further lengthened the process.[223] In addition, the members of the Committee were engaged people who essentially volunteered to serve on the Committee.[224] Time became a scarce resource under those circumstances. Apparently, there were no significant pressures on the Committee to finish its work.[225] In the instances where market realities or political pressures did require a reform, the Committee released partial amendments, which were later incorporated in the new law.[226]

Second, the instrumental functions of the Barak Committee were mainly the direction of policy and the incorporation of certain interest groups that might affect the implementation of the future law. In that sense, it resembled more the role of Ministry of Finance committees than that of Ministry of Interior committees. Indeed, Professor Procaccia's proposal is better seen as the baseline for the Barak Committee's deliberations than as a binding policy, which was dictated by the Justice Ministry and merely legitimized by the public advisory committee.[227] As for the policy directing function, it seems that the Committee enjoyed maximal independence in its work and recommendations. The loose language of the letter of appointment, the formal skills of the Committee members, the availability of the

222. Indeed, two other committees that dealt with a task similar in size to that of the Barak Committee, namely, the Civil Law Codification Committee, chaired by Justice Barak, and the insolvency law committee, chaired by Justice Shlomo Levin, have lasted comparable periods of time.

223. Although the Committee did not seem to reopen issues it already considered, it was responsive to changing conditions in that it reorganized its agenda accordingly. *See* Interview with Davida Lahman-Messer, Deputy Attorney General, the Justice Ministry, in Jerusalem, Israel (Aug. 11, 2002) (on file with author).

224. *See* Interview with Prof. Joseph H. Gross, Tel Aviv University Faculty of Law and Gross, Klienhendler, Hodak, Halevy, Greenberg & Co. Law Offices, in Tel Aviv, Israel (July 24, 28, 2002).

225. Compared to tax legislation that touches everyone's pocket, corporate law legislation was perceived as less urgent.

226. The reference here is to the Securities Law (Amendment No. 9), 5748-1988, which regulated class actions; the Law for Amending the Companies Ordinance (No. 4) (functionary's accountability), 5751-1991; and the Securities Regulations (Limitations on the Matter of Conflict of Interest between a Listed Company and Its Control Holder), 5754-1994.

227. *See* Procaccia, *supra* note 7, at 632.

supporting staff, and the elaboration of the Committee's report, all point in that direction.[228] Moreover, the professional and academic qualifications of the Committee members reinforced the perception of the Committee as a body capable of policy guiding.[229]

As for the incorporation function, the participation of high level officials of the Justice Ministry, the ISA, the TASE, and the Bank of Israel, not only in the Committee's discussions but also in its decision-making, increased the chances that these entities would support the future legislation and its implementation.[230] Indeed, the abovementioned institutions were crucial factors in the adaptation of the stock exchange and securities regulation for a new corporate law. The compromise and consensus in decision-making further enhanced the chance of successful implementation,[231] although they did not prevent disagreements from emerging in the subsequent stages of the legislative process.[232] Moreover, the limited inclusion of other interested parties, such as the Bar, the Institute of CPA's, the Manufacturers' Association, the Association of Publicly Traded Companies, and the Banks' Association in the Barak Committee resulted in their later massive involvement in the parliamentary committee, an involvement that affected the coherence of the legislation and occasionally went against the Barak Committee recommendations.[233]

Finally, with regard to legislation in general and corporate law legislation in particular, it seems that Israel follows the English tradition

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228. *Cf.* Harari & Hofnung, *supra* note 211, at 61-62 (identifying these kind of factors as indicators for the function of policy directing).

229. *See id.* (emphasizing the importance of formal qualifications for the projection of a policy as appropriate). As was mentioned above, the Ministers' Committee for Legislation adopted the Barak Committee's Report, as slightly revised by the Justice Ministry representatives, after only three hours. The then Minister of Justice, David Libaei, the head of the Ministers' Committee, declared that he was not about to undermine the recommendations of the most prominent corporate law experts. *See* Interview with Judge Michal Agmon-Gonen, *supra* note 203.

230. On the importance of the implementation of reforms, see Alex Radian & Ira Sharkansky, *Tax Reform in Israel: Partial Implementation of Ambitious Goals*, 5 POL'Y ANALYSIS 351 (1979).

231. *See* Harari & Hofnung, *supra* note 211, at 63.

232. *See* Interviews with Eran Rosman, Justice Ministry representative to the parliamentary committee, in Tel Aviv, Israel (July 22, 2002) (on file with author); Judge Michal Agmon-Gonen, *supra* note 203.

233. *See* Procaccia, *supra* note 187, at 305.

of assigning judges to chair public advisory committees.[234] In that respect, although contrary to the American doctrine of separation of powers, appointing a justice to chair a public committee for reforming corporate law made perfect sense in the Israeli context.[235] What is more unique in the case of Justice Barak is the deference that everyone involved in the process awarded him. It seems that this deference not only shaped the consensus in the Committee's recommendations but also ensured that, as opposed to former attempts, this endeavor would be fruitful and result in a new corporate law.[236]

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234. By the end of the 19th century and during the first half of the 20th century, the British Board of Trade conducted a practice of appointing advisory committees to review and amend the Company Law every twenty years. *See* PAUL L. DAVIES, GOWER'S PRINCIPLES OF MODERN COMPANY LAW 48-49 (6th ed. 1997). These committees were usually chaired by a judge, e.g., the Cohen committee that submitted its report in 1945 or the Jenkins Committee that reported in 1962. Similarly, the Law Commissions for England and Wales and Scotland, an independent body established by the British Parliament in 1965 to review the law and recommend reform when it is needed, is chaired by a High Court judge who is appointed, like the other four commissioners, by the Lord Chancellor. *See* http://www.lawcom.gov.uk/77.htm. Furthermore, the recent Company Law Review, a three-year comprehensive attempt to create a modern British corporate law, included among the members of its Steering Group a High Court judge with a high reputation as a company lawyer. *See* Jonathan Rickford, *A History of the Company Law Review*, *in* THE REFORM OF UNITED KINGDOM COMPANY LAW 3, 8-11 (John de Lacy ed., 2002). A comparison between the British Company Law Review and the Israeli initiative that resulted in the new corporate law goes beyond the scope of this paper and will be left for a future time.

235. Out of more than twenty public legislation committees in Israel, only one, the contract law committee, was not chaired by a judge. This committee was chaired by the late Professor Gad Tadeski, a contract law expert. *See* Interview with Chief Justice Aharon Barak, the Supreme Court of Israel, in New Haven, CT (Sep. 28, 2002) (on file with author). *See also* THE INVOLVEMENT OF THE SUPREME COURT AND ITS PRESIDENT IN THE LEGISLATION WORK (NO. 101), D.K. (2000) (responding to a MK's question, the Minister of Justice acknowledged that Supreme Court Justices were always involved in the groundwork of bills, and that there is no fault in this practice).

236. *See, e.g.*, Procaccia, *supra* note 7, at 632 n.11 ("Justice Barak's contribution to the final product was enormous. I am convinced that had it not been for his inexhaustible patience and strong leadership throughout the committee's long journey, the project would never have begun.").

B.3. The Parliamentary Process

The Barak Committee submitted its report to the Minister of Justice at the end of 1994.[237] Justice Ministry representatives further revised the report, and the Ministers' Committee for Legislation then adopted it, as any other governmental bill.[238] At the end of 1995, the Knesset endorsed the blueprint and referred it to the Constitution, Law, and Justice Committee.[239] Thereafter, the Constitution, Law, and Justice Committee constituted the Subcommittee on the matter of the Companies Bill, 1995, which prepared the bill for legislation.[240]

Before describing the Subcommittee's deliberations, some background on the working methods of parliamentary committees in Israel is required.[241] The Knesset currently has twelve permanent committees with fifteen to seventeen members each.[242] The permanent committees, of which the Constitution, Law, and Justice Committee is one, are free to appoint subcommittees to help them with their workload. No guidelines exist with regard to the composition, duration, membership, or competence of subcommittees. Similar to the rules applied to the Knesset plenum and to the permanent committees, there is no quorum requirement for subcommittees' deliberations or voting.[243]

When engaging in legislation, the Knesset committees (or subcommittees) will usually invite official and unofficial representatives to participate in their meetings.[244] However, the committees differ with

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237. *See* Companies Bill, 1995, at 2.

238. *See id.* (stating that the official explanation of the bill is mostly a literal adaptation of the Barak Committee's Report). A bill memorandum that was distributed by the Justice Ministry to all relevant parties prior to its approval as a blueprint resulted in only few responses. *See* Interview with Davida Lahman-Messer, *supra* note 223.

239. The process in which the Knesset approves a governmental bill and refers it to a parliamentary legislative committee is known as "first reading" – the first stage of a tri-partite legislative procedure. *See generally* REUVEN Y. HAZAN, REFORMING PARLIAMENTARY COMMITTEES: ISRAEL IN COMPARATIVE PERSPECTIVE 55-57 (2001).

240. *See* THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, THE SETTING UP OF A SUBCOMMITTEE FOR THE COMPANIES LAW (Dec. 13, 1995).

241. For an overview of the Knesset committees, see HAZAN, *supra* note 239, at 47-74.

242. *Id.* at 61. The only exception is the Knesset (House) Committee, whose maximum membership is set by the Knesset after each election. In the 15th Knesset, this Committee comprised of twenty-five members. *Id.* at 53.

243. *Id.* at 52.

244. *Id.* at 55. Note that except for committees of inquiry, the Knesset committees

regard to the part these representatives take in the discussions. While the Finance Committee first hears the different representatives and later conducts its deliberations in the presence of only the government representatives, the Constitution, Law, and Justice Committee discusses and decides issues in the presence of all the invitees.[245]

No time limits exist for passing a bill through a committee, and the procedural reporting requirements are easy to comply with. Hence, the speed of the legislation is contingent upon "the nature, length, and urgency of the bill, the committee's workload, and the committee chairman."[246] Indeed, the chairperson dictates the agenda and the work of the committee and has a crucial role in the legislative process of a bill.[247]

As for the membership of Members of the Knesset (MK) on the various Knesset committees (or subcommittees), it is hardly related to MKs' professional expertise or experience in a committee. Moreover, multiple committee membership coupled with the absence of a quorum requirement has resulted in very low attendance rates and a reality in which MKs show up in a committee only to cast their vote.[248] Bearing in mind the general change that the Israeli political environment has gone through since the 1990s, and the role of the media in this transformation,[249] these participation patterns are consistent with the general inclination toward "a reduction in the attention awarded to important but either not newsworthy or long-term legislation, in exchange for an appeal to the lowest common denominator, the immediate and the popular."[250]

Due to budgetary limitations, the independent counsel and

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are not empowered to subpoena witnesses and documents.

245. *See* Interview with Eran Rosman, *supra* note 232.

246. HAZAN, *supra* note 239, at 55.

247. *Id.* at 69-70.

248. *Id.* at 66-69.

249. The reference here is to the two new Basic Laws concerning the judicial branch; the introduction of direct elections for the prime minister (a reform that was abolished following the 2001 elections): the adoption of primaries as the preferred method of candidate selection; and new laws on parties and party finance. The personification of the political discourse, that was one of the outcomes of these reforms, was furthered by the introduction of cable TV and a second national channel which provide politicians increasing opportunities for public exposure. *See id.* at 49-51.

250. *Id. at* 50.

administrative measures available to the Knesset committees have been quite restricted. In essence, the permanent committees (and their subcommittees) are dependent on the government ministries for professional knowledge and base their decisions, *inter alia*, on the media and on reports of interested parties.[251] Under these conditions, it is a common practice for a committee to invite several interested parties in order to create a conflict among them, with the hope that the conflict would reveal the truth and compensate for inadequate research expertise.[252] However, the danger latent in this practice is that "without the ability to access impartial research on important subjects, the committee members might not possess the proper tools to evaluate the evidence that is presented to them, and the debate might revolve around contentious data."[253] In addition, the continuing reliance of the Knesset committees on the executive for professional advice has given the administration a significant informational advantage.[254]

Against this backdrop, the attributes of the Subcommittee on the matter of the Companies Bill, 1995,[255] discussed below, seem in no way unique and characterize quite fairly the common practice of the Knesset committees and subcommittees.

The Subcommittee consisted of four MKs; none of them except for the chairperson was present on a regular basis.[256] In contrast, the participation of interest groups, as invitees, was quite considerable. Representatives of the Bar, the Institute of CPA's, the Manufacturers' Association, the Association of Publicly Traded Companies, and the Banks' Association were present at practically all meetings. Similarly, representatives of the TASE, the ISA, and often the Companies Registrar, the Ministry of Finance, and the Bank of Israel took part in

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251. *Id.* at 73.

252. *See* Interview with Dr. Reuven Y. Hazan, The Hebrew Univ. of Jerusalem Dep't. of Political Science, in Jerusalem, Israel (July 9, 2002).

253. HAZAN, *supra* note 239, at 73.

254. More profound questions regarding the role of the bureaucracy in the modern democracy go beyond the scope of this paper.

255. *See* THE SUBCOMMITTEE OF THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, ON THE MATTER OF THE COMPANIES BILL, 5755-1995, 13TH KNESSET, 5TH SESS., PROTOCOLS NO. 1-7 (1995-1996) [hereinafter the Parliamentary Subcommittee or the Subcommittee].

256. *See id.* According to the official protocols, no other MK was present in the first seven sessions of the Subcommittee that took place during the 13th Knesset.

the discussions.[257] In addition, representatives of the Justice Ministry, and occasionally Professors Procaccia and Gross of the Barak Committee, attended the sessions.

The Subcommittee considered the Companies Bill for three years in the course of two Knesset sittings, the 13th and the 14th.[258] During this period of time it conducted thirty-seven meetings.[259] The work of the committee was elaborate and extensive. It went article by article, drafting the different arrangements into definite legislative language. The sessions were conducted by the chairperson, who permitted the participation of anyone who wished to appear before the Subcommittee, not as a witness whose knowledge was crucial to the process, but rather as a concerned party representing its own opinion or world-view.[260] Observing the "negotiation" between the Justice Ministry representatives and the other participants, the chairperson, a bit like an arrest judge, a bit like a technical person, would separate the gist from the trivial with the purpose of putting into effect a reasonable product.[261] Usually, the other invitees would submit their comments to the Justice Ministry representatives in advance. The latter would shape their stance on the matter, so that the Subcommittee would dwell only on the disputed issues. In this context, it is noteworthy that several agreements and compromises, some of them on substantial issues, were reached outside the Subcommittee's meeting room.[262]

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257. Note that the Companies Registrar acts under the Justice Ministry and performs an administrative function.

258. The length of the parliamentary process regarding the Companies Bill is exceptional and ensued from the extent of the legislation. *See* THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, 14TH KNESSET, 4TH SESS., PROTOCOL NO. 266, 3 (Dec. 1, 1998).

259. During the 13th Knesset, the Subcommittee, headed by MK Dan Meridor, conducted seven sessions. In its next cadence, the Subcommittee was headed by MK and later Deputy Minister Eliezer Sandberg and conducted another thirty sessions. Both MKs possess legal education. For the full list of invitees to the Subcommittee meetings, see *infra* Appendix D.

260. *See* Interview with Eliezer Sandberg, Chairperson of the Parliamentary Subcomm. during the 14th Knesset, in Jerusalem, Israel (July 9, 2002) (on file with author).

261. *See id.*

262. The reference here is to matters such as mergers and acquisitions, the company's capital, and shareholder's fairness duty. *See* Interviews with Eran Rosman,

After hearing the different participants, the Subcommittee members would decide the issue. These were the instances where MKs, often armed with pre-dictated responses, would storm into the meeting room and express their reservations. That was when lobbying and logrolling manifested themselves.[263]

Nevertheless, it seems that the Subcommittee's deliberations, taken as a whole, ran effectively and were to-the-point. Following professional lines, the Subcommittee was able to produce the bulk of the legislation in a manner which all concerned parties found acceptable.[264] This is not to say that some insignificant issues from a corporate law perspective did not gain exaggerated attention due to their effect on special interest groups.[265]

The main criticism or retrospective contemplation of the people involved in the process has to do with the indifference of Subcommittee members, with the input on which the Subcommittee based its decisions, and with the tone of the discussion. More specifically, it was argued that most of the Subcommittee members did not demonstrate seriousness in their work, that they were not conversant in the issues and often more interested in publicity than in substance, and that the information offered to them by the invitees was partial and not always profound. It should be emphasized, in this regard, that the Subcommittee did not summon individuals or groups to appear before it. Rather, the people who asked to be invited to the sessions, whose schedule was publicly known, had an interest in opening the Subcommittee's eyes regarding the "right way."[266] The flip side of this situation is that other parties with interests

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supra note 232; Omri Yadlin, Tel Aviv University Faculty of Law, representative of the Manufacturers' Association of Israel to the parliamentary committee, in Tel Aviv, Israel (July 7, 2002) (on file with author). For further discussion of these specific issues, see *infra* Part III.B.

263. *See* Interviews with Eliezer Sandberg, *supra* note 260; Prof. Uriel Procaccia, *supra* note 192; Judge Michal Agmon-Gonen, *supra* note 203.

264. *See* Interview with Eliezer Sandberg, *supra* note 260.

265. The two prominent examples for this phenomenon are the debates regarding the definition of the company's external accountant, as distinguished from the company's internal auditor, and regarding the question of who can audit companies' reports, only a CPA or also, under certain circumstances, a tax advisor. Both issues were revisited in the final meetings of the Constitution, Law, and Justice Committee, before approving the bill and forwarding it to the Knesset plenum. *See* THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, *supra* note 258, at 10, 30.

266. *See* Interview with Eliezer Sandberg, *supra* note 260.

that might have been pertinent to corporate law legislation, such as institutional investors, small creditors, or workers' unions, did not provide input to the Subcommittee.[267]

In addition, and as opposed to the Barak Committee, the atmosphere surrounding the Subcommittee meetings was polemic, to say the least. Power struggles, yelling, and aggressiveness were the nouns mentioned in this context. In the words of Professor Procaccia: "Many of the Knesset Members did not look favorably on the involvement of the professional level, the Justice Ministry staff and the Barak Committee's representatives, and often hushed them rudely."[268]

B.4. Epilogue

Once the Subcommittee completed its work, the amended bill was submitted to the Constitution, Law, and Justice Committee for its approval.[269] The Committee discussed only a handful of issues that were not resolved in the Subcommittee and returned the bill to the Knesset plenum.[270] On April 19, 1999, the Knesset passed the Companies Law in a special session.[271] The law came into force as of February 1, 2000,[272] but the process did not end there. It continued in another parliamentary subcommittee that discussed the law's regulations with respect to issues that were delegated to the Minister of Justice[273] and a

267. *See* Interview with Davida Lahman-Messer, *supra* note 223; *cf.* Eliezer Sandberg, *Statement of the Head of the Legislative Subcommittee on the Companies Bill*, 1 SHA'AREI MISHPAT 261 (1998) (stating that in order to create a well implemented law, the committee heard from representatives of various groups and organizations that the committee considered to be the users of the new law, namely: the Bar, the Association of Publicly Traded Companies, the Banks, the Institute of CPAs, expert academics, the ISA, and the TASE. Institutional investors, consumer groups, and academics or lawyers who advocate for small shareholders were not, however, included among them).

268. Procaccia, *supra* note 187, at 305 (translated freely by author).

269. *See* THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, *supra* note 258, at 3.

270. *See id.*

271. The special session was required due to the Continuity of Bill Discussion Law, 1993, which enabled succeeding discussion of a bill in only one subsequent Knesset.

272. *See* Companies Law, 1999, § 377.

273. *See* Companies Law, 1999, § 366(b) (conditioning the regulations on the approval of the Constitution, Law, and Justice Committee).

governmental bill that resulted in a law amending the newly enacted law.[274] The story of the amendment and related initiatives is discussed in detail in Part III of this paper.[275]

In order to evaluate main provisions of the new corporate law and their responsiveness to various interest groups, the next section outlines the relevant interest groups with respect to corporate law legislation in the Israeli setting.

C. Relevant Interest Groups

Based on the characteristics of the Israeli economy and the legislative process portrayed above, various groups might have been expected to have a prominent interest in corporate law legislation. This does not necessarily mean that all of them participated in the legislative process. This section discusses the various interest groups and evaluates their relative strengths and participation patterns.

C.1. Regulators

Two distinct bodies of the Executive were deeply involved in the legislative process of the new law: the Justice Ministry and the Israel Securities Authority (ISA). Not only are these bodies separate entities,[276] but they also differ in their goals and perception of corporate law legislation, as well as in their situs in the political arena.

The Justice Ministry representatives perceive themselves as representatives of the public at large and corporate law as a balancing code among the different interests involved. These interests include not only shareholders, but also customers, creditors, and employees.[277] The Justice Ministry does not employ lobbyists in the Knesset. Its strength is derived from the decisiveness and professionalism ascribed to its personnel.[278]

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274. The law includes both technical and substantial amendments and was passed by the Knesset on March 7, 2005. *See* Companies Law (Amendment No. 3), 2005.

275. *See infra* Part III.B.

276. Under the Securities Law, the ISA is an independent regulatory agency, whose members are appointed by the Minister of Finance.

277. *See* Interview with Davida Lahman-Messer, *supra* note 223.

278. *See, e.g.*, Bar Cohva & Magen, *supra* note 186; Ronit Vardi, *Davida Lahman-Messer and Her Fight Against the Lobbyists*, GLOBES ELECTRONIC ARCHIVE, June 13,

Since legislation regarding Israeli corporations falls under the authority of the Minister of Justice, representatives of the Justice Ministry were involved in the legislative process from its inception.[279] A review of the Subcommittee protocols indicates that the Justice Ministry representatives usually received comments from the other Committee's invitees in advance and introduced the issues discussed in each Subcommittee meeting. In essence, they had considerable control over the proportional weight given to each matter. The drafting task of the bill was also left in the hands of the ministry representatives. Likewise, they were responsible for the drafting of the law's regulations and the Companies Bill (Amendment), 2002.[280]

As for the ISA, the Securities Law defines its role as the protection of investors' affairs.[281] The ISA interpreted this statutory provision to mean that its role is the creation of a fair and functioning capital market. Consequently, the ISA representatives emphasize the importance of enforcement in encouraging investors' trust in the market. They conceive economic legislation, including corporate law legislation, as an ordering instrument that enables the economy to work, rather than as an independent justice mechanism in its own right.[282] Moreover, unlike its American counterpart, the ISA views the highly concentrated ownership structure of Israeli companies as the unique and main problem of the Israeli capital market. Accordingly, it justifies stricter rules as a means to protect minority shareholders against control holders.[283]

Following the change of personnel at the head of the ISA in 1987 and the resultant rise in its status in the economy, the ISA became an active participant in the legislative process of the new corporate law. The Chairperson and the Legal Advisor of the ISA attended the Barak Committee meetings on a regular basis. Representatives of the ISA participated in all of the meetings of the Parliamentary Subcommittee and kept in close touch with the Justice Ministry representatives.

Other regulating bodies, such as the Ministry of Finance and the

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2002.

279. *See supra* text accompanying notes 207-208.

280. Drafts of the bill were published on the Justice Ministry website at www.justice.gov.il.

281. *See* Securities Law § 2.

282. *See* Interview with Arie Mientkavich, *supra* note 125.

283. *See id.*; Interview with Dr. Shimon Wise, *supra* note 125.

Bank of Israel took part in the legislative process to a much lesser extent. Although their representatives were present at some Barak Committee and the Parliamentary Subcommittee sessions, it seems that their overall involvement in the process was relatively minor.[284] The minimal involvement can be attributed to the allocation of authority between the different governmental agencies and the ability of these bodies to exert direct influence on other aspects of commercial legislation, such as banking, tax, and capital market regulation.

C.2. Business Service Providers

Various service providers and intermediaries were involved in the legislative process. Aside from the TASE, whose representatives participated in the Barak Committee meetings, representatives of other bodies, such as the Israeli Bar, the Institute of CPAs, and the Institute of Internal Auditors only had a share in the Parliamentary Committee meetings.

As mentioned above, the TASE heads were invited to take part in the Barak Committee meetings.[285] In addition, the sole TASE representative participated in the majority of the Subcommittee meetings.

It is noteworthy that the TASE role in regulating the stock exchange and the principal conceptions held by its Managing Director have changed conspicuously in the course of the legislation of the new law. With the empowerment of the ISA at the end of the 1980s and its taking over the regulation of various issues of corporate governance, the TASE has focused on facilitating the trade and listing of companies on the exchange. Since the mid-1990s, when the listing of Israeli Companies on the NASDAQ became a common phenomenon,[286] the TASE has shifted its approach from a pro-investor, paternalistic position to a pro-company, business-oriented one. TASE's explanation for this shift is that, in the long run, the factor which dictates the size, the vitality, and

284. Each of these bodies was represented in less than half of the Parliamentary Subcommittee meetings, usually by no more than one representative. For the sake of comparison, the Justice Ministry and the ISA were represented in virtually all of the Subcommittee meetings, each having, on average, three representatives. *See* Appendix D for the full list of invitees to the Subcommittee meetings.

285. *See supra* text accompanying notes 154-157.

286. *See supra* text accompanying notes 154-57.

the contribution of the capital market to the economy is the supply of companies rather than the demand of investors.[287]

As for the Israeli Bar and the Institute of CPAs, their representatives participated in a considerable part in the Parliamentary Subcommittee meetings.[288] While the Institute of CPAs used intensive lobbying regarding its concerns, the Bar representation was regarded by most other participants in the legislative process as trivial and lacked strong professional backing by leading corporate lawyers.[289] This might have been the result of the fact that the Bar committee for corporate law legislation is based on voluntary membership, met only sporadically during the legislative process, and did not enjoy strong political support or professional esteem.[290]

Other groups of service providers, such as the Institute of Internal Auditors, the Tax Advisors Bar, and the Insurance Companies' Association, sent their representatives to selected Subcommittee meetings when their direct interests were at stake.

C.3. Shareholders, Managers, and Control Holders

Two bodies that represent shareholders, managers, and control holders, the Association of Publicly Traded Companies and the Manufacturers' Association, took part in the legislative process. Although representing different segments of the economy, the interests of these two bodies with regard to the new corporate law converged on most issues.[291]

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287. *See* Interview with Saul Bronfeld, *supra* note 74.

288. The Bar representatives, usually one or two in number, participated in 34 (out of 37) of the Subcommittee meetings. One to three representatives of the Institute of CPAs participated in 18 of the Subcommittee meetings. *See* Appendix D.

289. *See* Interviews with Prof. Uriel Procaccia, *supra* note 192; Prof. Joseph H. Gross, *supra* note 224; Eran Rosman, Justice Ministry representative to the parliamentary committee, in Tel Aviv, Israel (July 22, 2002). In the early stages of the parliamentary process both the Bar and the Institute of CPAs were represented by Michel Ohayon of the Israeli Bar. Later, Mr. Ohayon kept representing the Bar, on a voluntary basis, as a member and later the elected chairperson of the Bar committee for corporate law legislation. *See* Interview with Michel Ohayon, *supra* note 204.

290. For a comparison of the different roles the Bar plays in Israel and in the U.S., see *infra* text accompanying notes 716-27.

291. *See also* THE SUBCOMMITTEE OF THE CONSTITUTION, LAW, AND JUSTICE

The Association of Publicly Traded Companies was established in 1991 by a group of Chairpersons and CEOs of public companies and lawyers, as a response to strict regulation of the companies listed on the Tel Aviv Stock Exchange by the TASE and the ISA.[292] Aiming at representing public companies before the executive and legislative authorities, the Association aspires to be a balancing factor, which raises the practical aspects and consequences of regulating different activities of those companies.[293] Although formally acting for public companies as a whole rather than for the shareholders, managers, or directors, in essence, due to the concentrated ownership structure of the Israeli capital market,[294] the Association's interests usually coincide with those of the control holders who dominate the market.

In a relatively short period of time since its inception, the Association of Publicly Traded Companies became involved in legislation concerning public companies.[295] With respect to the new corporate law, the Association sent its remarks to the Barak Committee Report which was then distributed by the Justice Ministry to different groups and organizations, prior to its approval as a blueprint. Later, the Association representatives, usually 2 or 3 in number, participated in each of the 37 meetings conducted by the parliamentary subcommittee. In addition, the Association was one of the driving forces behind the Companies Bill (Amendment), 2002.[296]

COMMITTEE, ON THE MATTER OF THE COMPANIES BILL, 5755-1995, 13TH KNESSET, 5TH SESS., PROTOCOL NO. 1, 29 (Dec. 24, 1995) (In his opening statement to the Subcommittee, the representative of the Association of Publicly Traded Companies noted that in order to facilitate the work of the committee, the two organizations had agreed to coordinate their comments with regard to public companies.).

292. *See* http://www.e-good.org.il/about_us/default.asp.

293. *See* Interviews with Gad Soen, Managing Director, The Ass'n of Publicly Traded Companies, in Tel Aviv, Isr. (July 8, 2002) (on file with author); Nathan Shilo, Legal Adviser, The Ass'n of Publicly Traded Companies, in Tel Aviv, Isr. (July 14, 2002) (on file with author). The Association consists of 200 to 250 companies (out of about 600 companies currently listed on the TASE). According to Mr. Shilo, due to the prevalence of control groups, each holding several public companies, in effect, the Association represents 400 to 500 listed companies.

294. *See supra* text accompanying notes 134-42.

295. *See* Interview with Gad Soen, *supra* note 293.

296. *See, e.g., The Amendments to the Companies Law were Approved by the Ministers' Committee of Legislation and Passed to the Knesset's Constitution Committee*, THE ASS'N OF PUBLICLY TRADED COMPANIES, PRESS RELEASES, May 1, 2002, *available at* http://www.e-good.org.il/news/content.asp?ID=93.

The Manufacturers' Association was established in 1921, and its goal is to represent the interests of the industrial sector in dealing with governmental authorities and to improve its status. The Association's members consist of 1700 factories, including the largest industrial companies operating in the Israeli economy. In the past, a large part of the Association's activity was directed towards the employment relationship. Today, it has extended its interest to economic policy and foreign trade and has taken a dominant role in lobbying with regard to economic legislation.[297]

Similar to the Association of Publicly Traded Companies, the Manufacturers' Association became involved in the legislative process of the new corporate law in a more meaningful way once the Knesset endorsed the Companies Bill, 1995, as a blueprint. It participated in 29 meetings of the Parliamentary Subcommittees and hired external legal experts to represent its interests in those meetings.[298] For the most part, those interests corresponded to the interests of the business sector at large, and in particular to the interests of managers and control holders. The notion was to create a useful and efficient law.[299] The Manufacturers' Association also employed intensive political lobbying with regard to certain issues that it conceived as significant and was active in the post-enactment proceedings that resulted in the amending law.[300]

C.4. Creditors

The Banks' Association, in which all local banks are members, is the main body that represented creditors in the legislative process of the new corporate law.[301] Despite the extensive role of banks in the Israeli

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297. *See* Interview with Shuki Abramovich, Director of the Economy Division, the Manufacturers' Ass'n of Israel, in Tel Aviv, Isr. (Aug. 12, 2002) (on file with author).

298. The Manufacturers' Association first hired the services of Dr. David Tadmor, then a private lawyer. When Dr. Tadmor was appointed as the head of the Israeli Antitrust Authority, he was replaced by Dr. Omri Yadlin of Tel Aviv University Faculty of Law.

299. *See* Interview with Omri Yadlin, *supra* note 262.

300. *See* Interview with Shuki Abramovich, *supra* note 297.

301. *See also* Interview with Davida Lahman-Messer, *supra* note 223 (noting the minor participation of the Bank of Israel and the fact that it protects only insured creditors).

economy and the multiple hats they wear,[302] the Banks' Association primarily represented the interest of the banks as commercial banks; that is, as creditors.[303]

The Banks' Association was mostly involved in the parliamentary stage of the legislative process.[304] One or two representatives of the Association were present in the vast majority of the Subcommittee meetings and their work was considered serious and professional.

It is noteworthy that small creditors, such as suppliers and consumers had no representation in the legislative process.[305] Their interests were considered to the extent that it was consistent with the interests of the banks and as part of general interest in the importance of protecting creditors in corporate law legislation.[306]

C.5. Non-Participating Groups

Two groups that might have been expected to take an active part in the adoption of new corporate law were absent from the legislative arena: institutional investors and labor organizations. Against the background of the Israeli economy, their absence can be easily explained.

With regard to institutional investors, the various limitations still imposed by the government on pension funds and provident funds discouraged them from taking an active role in corporate governance as investors of the companies in which they invest. As a result, their interest in corporate law legislation was limited.[307] Moreover, the

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302. *See supra* text accompanying notes 113-17.

303. *See* Interview with Ruth Shikler, Deputy Chief Legal Adviser, Bank Leumi, representative of the Banks' Association to the parliamentary committee, in Tel Aviv, Israel (Aug. 13, 2002) (on file with author). Others interests in play were the interests of the banks as shareholders, as companies, and as exchange members.

304. This is not to say that informal contacts with the banks did not exist during the Barak Committee sitting. *See* Interviews with Dr. Shimon Wise, *supra* note 125; Judge Michal Agmon-Gonen, *supra* note 203.

305. *See* Interview with Davida Lahman-Messer, *supra* note 223.

306. *See* Interviews with Ruth Shikler, *supra* note 303; Eliezer Sandberg, *supra* note 260; Eran Rosman, *supra* note 232.

307. Notice that since Jan. 1, 2003, due to an amendment in the Income Tax Ordinance, pension funds and provident funds are allowed to appoint directors and to hold up to 50% of the shares of the companies in which they invest, as opposed to a 25% cap that was previously in effect. This amendment is expected to increase the

dominance of the banks in the economy and the fact that they hold most of the mutual funds might have neutralized the managers of those funds from taking any active role in the legislation.[308] As mentioned above, the Banks' Association first and foremost represented their interest as creditors rather than shareholders.

As for labor organizations, although an extensive discussion of the labor relationship in Israel is beyond the scope of this paper, it is sufficient to note here that workers' organizations have traditionally used the well developed system of Israeli labor law to protect their interests.[309]

C.6. Other Considerations

For the sake of completeness, two other factors that have shaped the structure of the Corporations Law, 1999, should be pointed out prior to analyzing the influence of interest groups on the legislative process.

First, as will be discussed in detail in the next part of this paper, the new corporate law is an overall reform based on a proposal made by Professor Procaccia.[310] This pattern by itself gave rise to numerous criticisms by the business sector, which feared that the new provisions (or the lack thereof) might expose it to new liabilities and uncertainties.[311] Creativity was not a virtue valued by the users of the law.[312]

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monitoring power of institutional investors. *See* Globes Service, *Starting Jan. Institutional Investors Could Hold up to 50% of a Corporation's Control Instruments,* GLOBES ELECTRONIC ARCHIVE (Dec. 23, 2002).

308. At the end of 2002, the 25 largest mutual funds, which held approximately 50% of the overall assets of the mutual fund industry, were affiliated with the three largest banks: the Poalim, Leumi and Discount. *See* Daphna Zuker, *The Assets of the 25 Largest Funds - 50% of all Funds,* GLOBES ELECTRONIC ARCHIVE, (Feb. 25, 2003).

309. For an elaborate discussion of the labor relationship in Israel, see MENACHEM GOLDBERG & JOSEPH HAUSMAN, LABOUR LAWS, LAWS, REGULATIONS, ORDERS, COLLECTIVE AGREEMENTS, PRECEDENTS, COMMENTARIES (38th ed. 2003).

310. *See, e.g.*, Procaccia, *supra* note 7.

311. *See* Interviews with Shuki Abramovich, *supra* note 297; Ruth Shikler, *supra* note 303; Saul Bronfeld, *supra* note 74; Arie Mientkavich, *supra* note 125.

312. *See also* Interview with Judge Michal Agmon-Gonen, *supra* note 203 (noting that since the enactment of the new law judges base their decisions on practical issues and avoid making a theoretical determination regarding innovative arrangements set by

Second, during the legislative process, no extensive thought was given to the ability of the Israeli court system to enforce corporate law legislation and the implication of this matter for the drafting of different provisions as standards or bright line rules.[313] In practice, however, an unspecialized court system that cannot immediately meet the needs of a vibrant business sector may result in a search for alternative solutions, such as arbitration or mediation. These solutions, while furnishing an immediate answer to the relevant parties, are less efficient for the economy at large since they do not create binding precedents or norms, which are important for a stable infrastructure for economic activity.[314]

D. Summary

This part of the paper presented the course of the production of the new Israeli corporate law. The accounts of Israel's economy, the legislative process of the new law, and the relevant interest groups that were laid out in this part provide the basis for the analysis of the political economy of corporate law legislation developed in the following part. In particular, examining the modifications of the law during the legislative process in light of those accounts will enable us to assess the responsiveness of different segments of the legislation to different groups and interests.

III. THE POLITICAL ECONOMY OF CORPORATE LAW LEGISLATION

The aim of this part of the paper is to provide a comprehensive analysis of the political aspects of the enactment of the new Israeli corporate law. It consists of three sections. The first section reviews the

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the new law).

313. *See* Procaccia, *supra* note 187, at 305-12 (noting that the lack of a specialized court system in Israel and the reservations that the court has with regard to economic considerations make it a less efficient producer of corporate laws). For the difference between standards and bright-line rules, see *infra* text accompanying notes 523-28.

314. *See* Interviews with Arie Mientkavich, *supra* note 125; Davida Lahman-Messer, *supra* note 223. *Cf.* Ehud Kamar, *Costs of Departures from Formalism: Shareholder Litigation under Indeterminate Corporate Law*, 66 U. CHI. L. REV. 887, 890 (1999) (arguing that litigation can reduce legal uncertainty since "[a]s decided cases accumulate, the interpretation and proper application of fiduciary standards become clearer, allowing directors and officers to estimate legal outcomes more accurately and thus to behave closer to the social optimum").

law's general characteristics and specific contents, as revised in the course of the legislative process. The second section examines empirical evidence regarding the actual impact of various interest groups during the different stages of the legislation. In an attempt to evaluate the effect of interest groups on the outcome of the Companies Law, 1999, and post-enactment proceedings, this section focuses on certain defining mechanisms established by the new law and their appropriateness for Israel's particular socio-economic and institutional attributes. The last section sums up the findings and offers a political theory framework of the Israeli corporate law.

A. The New Corporate Law – General Characteristics and Specific Contents

The new corporate law is an extensive and general statute that purports to modernize an anachronistic statutory setting and to codify the essence of Israel's common law that was developed by the judiciary.[315] Thus, the law redefines issues of incorporation, the legal entity, majority rules, rights and duties of shareholders and directors, allocation of authority, board structure and role, capital preservation, mergers and acquisitions, and filing requirements. It also codifies for the first time several issues regarding promoters, derivative action, and piercing the corporate veil.[316] Notably, the law is rich in standards, such as 'good faith', 'accepted way' and 'fairness', and leaves the regulation of various issues to the Minister of Justice.

A.1. General Characteristics

A number of principles formed the basis of Professor Procaccia's proposal and were adopted by the Barak Committee, whose work is the cornerstone for the new corporate law. First, the legal arrangements set by the law are intended to intertwine with the wider array of Israeli civil law and particularly with the general contract law.[317] Accordingly, the company's bylaws are defined as a contract between the company and

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315. *See* Companies Bill, 1995, at 2-5.

316. For a table comparing the Companies Ordinance and the prevailing common law to the Companies Law, 1999, see GROSS, *supra* note 122, at 383-92.

317. PROCACCIA, *supra* note 7, at 10-14.

its shareholders, and among the shareholders themselves.[318] Similarly, when applying rights and duties toward the company and toward its fellow shareholders, a shareholder is required to act in good faith and in an accepted way and to avoid abusing its powers.[319] However, when the corporate existence dictates a different kind of solution, the law diverts from the general civil law and provides a special arrangement that will fit the problem.[320]

Second, acknowledging the autonomy of private will, the law favors an enabling model of legislation. That is, it presupposes that enabling legislative arrangements are more efficient than mandatory ones and therefore limits the use of mandatory provisions only to extreme cases of market failure.[321] More specifically, Professor Procaccia's hypothesis is that the parties know best what is good for them and, thanks to market forces, are expected to reach an optimal solution. Based on interest-group theory, he contends that delegating to the legislature the power to shape arrangements will result in unnecessary burdens and costs that might be larger than the ones caused by market failures.[322] Regarding corporate law legislation, Professor Procaccia infers from the American "race to the top" theory the efficacy of enabling corporate law legislation in a monistic country like Israel. His reasoning is that instead of American interstate jurisdictional competition to assure an optimal legal product, the competition will occur among the bylaws of the different corporations in a monistic country.[323] In addition, the freedom of corporations to migrate and reincorporate in foreign countries reduces the gap between a federal system, which enables interstate competition, and a monistic system, which does not provide internal competition.[324] However, and despite his belief in the restraining power of the market, at least in the long run, Professor Procaccia acknowledges the necessity of mandatory legislation where market failures exist, such as in the case of

318. Companies Law, 1999, HH, § 17.

319. Companies Law, 1999, HH, § 192(a).

320. *See* Companies Bill, 1995, at 7.

321. *See* PROCACCIA, *supra* note 7, at 14-23; Uriel Procaccia, *Companies and Other Firms in a Theoretical Scope, in* MEMORIAL BOOK FOR GOALTIREO PROCACCIA – LEGAL ESSAYS 217, 228-34 (1996).

322. *See* PROCACCIA, *supra* note 7, at 17-18.

323. *Id.* at 20-21.

324. *See* Procaccia, *supra* note 321, at 231.

externalities or collective action problems.[325]

Finally, the legislation is based not only on efficiency considerations but also on principles of fairness and equality.[326] Yet, coinciding with the goal of the business corporation – the welfare of all the company's shareholders[327] – the principles of fairness usually parallel those of efficiency. That is, they are most relevant in incidents of market failure.

The Israeli law's architects thus envisioned a modern instrument that is meant to facilitate commercial activity through efficient and just arrangements. Notwithstanding Israel's own market realities, the concept that steered the legislation is a liberal one, and the common denominator of the abovementioned guidelines is that they all justify legal intervention only on the basis of a perceived market failure.[328]

Under these assumptions, the significance of identifying specific market failures and defining the mechanisms for overcoming them is immense. An unidentified market failure may result in inefficient or unfair allocation of resources, while over-regulation may hinder efficient transactions. Similarly, an improper treatment of market failures may cause various deficiencies, which are as acute as the market failures themselves.

Obviously, different interests would gain from different legal arrangements and, thus, might encourage the legislature to create mechanisms that benefit them, regardless of their overall impact. Section B attempts to trace this influence by analyzing the political dynamics that affected the legislation in different stages of the process.

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325. *See* PROCACCIA, *supra* note 7, at 21-23; Procaccia, *supra* note 321, at 232-34.

326. *See* Procaccia, *supra* note 321, at 236-37; Davida Lahman-Messer & Eran Rosman, *Statement of the Justice Ministry's Representatives*, 1 SHA'AREI MISHPAT 263 (1998). *See also* Procaccia, *supra* note 7, at 631 n.5 (noting that "it proved much easier to sway the relevant advisory and legislative committees to adopt a given idea if it could be shown that its rationale does not rest on economic analysis alone, but also on more abstract 'legal' considerations, such as 'reasonableness', 'good faith', or sheer everyday common sense").

327. Lahman-Messer & Rosman, *supra* note 326.

328. Indeed, in a lecture given in 1995 at the Benjamin N. Cardozo School of Law, Professor Procaccia stated: "I believe that Israel's future corporate code might be the first major statute in any Western jurisdiction which was explicitly conceived and designed to promote the 'Social Good', as interpreted with the aid of economic tools." *See* Procaccia, *supra* note 7, at 631.

A.2. The Companies Law's Content

The Companies Law, 1999, replaces the Companies Ordinance, except for the provisions regarding bonds, liens, and dissolution that are the subject of discrete ongoing legislative reforms.[329] It applies to both private and public companies, although its main focus is on the public (traded) company due to its distinct attributes.[330] Founded on the doctrine of the company's separate legal entity and setting the limited liability of the shareholders as a starting point, the new law is intended to regulate the company's actions, structure, and governance, as well as the relationship among the company's various constituencies.[331]

While generally based on Professor Procaccia's proposal, as revised by the Barak Committee, the law diverges from these sources on certain issues. The major modifications that occurred in the course of the legislative process will be discussed subsequent to the overview of the law's content.

The law consists of ten chapters.[332] The first chapter includes definitions of different terms used by the law. As part of the coordination between the Companies Law and the Securities Law, there exist cross-references regarding several definitions used by both, such as control, holding, acquisition, subsidiary, and class action. The second chapter is concerned with the incorporation of the company. Following Professor Procaccia's proposal and the Barak Committee Report, the new law has legitimized the one-person company, defined the company as a legal entity and set its end, codified the matter of promoters, abolished the ultra vires doctrine, and simplified the process of incorporation by creating a single document, the bylaws, that can be altered by a simple majority of the company's shareholders.[333] It has also codified the doctrine of piercing the corporate veil, though the

329. *See* THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, 14TH KNESSET, 4TH SESS., PROTOCOL NO. 266, 4 (Dec. 1, 1998).

330. *Id.* at 5-6.

331. *Id.*

332. *See generally id.* at 6-10; THE COMPANIES LAW, 1999 (SECOND READING AND THIRD READING) (NO. 287), D.K. (1999).

333. According to the Companies Ordinance, two different documents, the memorandum and the bylaws, were required in order to incorporate. They were only partially alterable and, if so, only through special majority rules. The Ordinance also included, as its second appendix, a sample of bylaws, which served as a default for limited companies.

boundaries of the doctrine, its application, and its formulation have been revised over and over during the different phases of the legislative process, as will be discussed further below.

The third chapter of the law lays out the company's structure. It sets out the company's organs and their authorities. These organs are: the general meeting of shareholders, whose vote is required on fundamental changes with respect to corporate structure or governance; the board of directors, whose role is to set the company's policy and supervise the management; and the Chief Executive Officer (CEO), who runs the company on a day-to-day basis.[334] Private companies are relieved from some of the provisions in this chapter, such as the duty to appoint a CEO.[335] On the other hand, public companies are subjected to additional provisions such as the postal vote or the prohibition against the chairperson of the board acting as the CEO.[336] Both of these latter provisions were modified by the Subcommittee.

The fourth chapter discusses the company's administration. It regulates the registration of shareholders (and block holders in public companies), as well as reporting and auditing requirements.

The next chapter is concerned with the company's shareholders and defines their rights and duties. It also codifies the areas of derivative suit and class action.[337] While adhering to the general notions of the Barak Committee, the Subcommittee altered the scope of some of the provisions in this chapter.

In its sixth chapter, the law deals with the company's managers and directors. It preserves the mechanism that was set by the Ordinance regarding the appointment of two independent directors to the board of a public company. However, following the Barak Committee, it diverges from the original arrangement with regard to the appointment method of these directors. Similarly, the law adopts the provisions on the subject of managers' and directors' rights and duties and conflict of interest transactions that were recommended by the Barak Committee and

334. This is a variation from the Companies Ordinance that set the board of directors as the organ who manages the company.

335. *See* § 119 of the Companies Law, 1999.

336. *See* §§ 87-89, 95 of the Companies Law, 1999.

337. The latter was temporarily codified in the Securities Law since 1988. *See* the Securities Law (Amendment No. 9), 1988 H.H. 5748.

incorporated into positive law prior to the Committee's final report.[338] The Subcommittee clarified these provisions and modified some of them.

The seventh chapter of the law regulates the company's capital. It is founded on the concept of "distribution," a term set by Professor Procaccia to include any reduction in the company's capital, be it through dividend or the repurchase of the company's shares.[339] The eighth chapter discusses mergers and acquisitions. It establishes new arrangements for statutory mergers and tender offers and prohibits street sweeps that result in a control block. The details of these arrangements have changed over the different stages of the legislation.

The ninth chapter consists of general provisions and is concerned, among others, with the enforcement of the law through monetary sanctions, an enforcement tool that was created by the Barak Committee.[340] It also deals with structural changes, other than the ones discussed in the previous chapter, and delegates to the Minister of Justice the right to regulate public companies that are listed outside of Israel, as well as any other issue that is required for the execution of the law. Finally, the last chapter of the law includes rules regarding the transition from the Companies Ordinance to the new law.

A.3. Major Modifications Occurring in the Course of Legislation

As mentioned above, notwithstanding the analytical framework suggested by Professor Procaccia and adopted by the Barak Committee and the Knesset Subcommittee, several of the actual legal arrangements were modified and revised during the various phases of the legislative process. Some of these revisions were technical or editorial, others were substantive. What follows is a review of the principal changes made in

338. *See* Law for Amending the Companies Ordinance (No. 4) (functionary's accountability), 1991 H.H., 5751. *See also* Securities Regulations (Limitations on the Matter of Conflict of Interest between a Listed Company and Its Control Holder), 1994 H.H. 5754.

339. The term "distribution" is defined in § 1 of the Companies Law, 1999.

340. *See* Michal Agmon & Davida Lahman-Messer, *The Enforcement Theory in the New Companies Bill*, 26 MISHPATIM 543, 578-682 (1996). *See also* Procaccia, *supra* note 7, at 632 n.10 (stating that "[t]he single most important innovation proposed by other committee members is the concept of 'monetary sanctions', a measure halfway between criminal fines and civil damages").

Professor Procaccia's original proposal. These will serve as a point of reference for the political analysis drawn in the next part of this paper. A summary table of the major modifications made during the legislative process is also attached as an appendix to this paper.[341]

Piercing the Corporate Veil

Following the common law tradition, the Israeli corporate law has adopted the concept of the company as a separate legal entity, having its own duties and rights, distinct from those of its shareholders.[342] The Companies Ordinance did not refer to the general doctrine of piercing the corporate veil, i.e., the attribution of the company's duties and rights to its shareholders, but, rather, mentioned some particular cases in which shareholders or managers should be held personally liable for their companies' debt.[343] The judiciary emphasized the general rule of limited liability and used the doctrine of veil piercing only in exceptional cases. The events that justified attributing duties of the company to a shareholder, as were developed by the courts, included circumventing the law; foiling legitimate expectations from a contract; fraud on creditors; alter ego theory; principles of agency; and, to a limited extent, the enterprise theory.[344] Undercapitalization was not recognized as a sufficient independent cause for piercing the veil.[345]

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341. *See infra* Appendix C.

342. *See* C.A. 524/88, Agricultural Cooperative Society Ltd. v. Sde Yaacov, 45(4) P.D. 529.

343. *See* §§ 99(b), 107 & 373 of the Companies Ordinance. Similarly, the Israeli law outside of the corporate law regime acknowledges specific cases, such as for tax or housing purposes, in which the traits of the company are attributed to its shareholders. In other cases, such as in the instance of extended terms due to emergency service, the law attributes a shareholder's traits to the company.

344. The enterprise theory enables the piercing of the corporate veil among subsidiaries and related companies. For a review of the absorption of this theory by the Israeli courts, see 1 IRIT HAVIV-SEGAL, CORPORATE LAW IN ISRAEL – AFTER THE NEW CORPORATIONS ACT 260-67 (1999).

345. For a critical review of the judicial trends on the matter, see HAVIV-SEGAL, *id.* at 245-56. *Cf.* C.A. 2223/99 *Krispi v. H. Electronica (1988) Ltd.* (unpublished), *available at* http://www.court.gov.il (asserting that the Supreme Court, although not in a positive and explicit manner, acknowledged undercapitalization as a cause for veil piercing).

In his proposal, Professor Procaccia suggested discarding the existing statutory reasons for piercing the corporate veil and imposing personal liability on managers and directors only in the case of breaching the reporting duties of the company.[346] Regarding the legislation of the judicial doctrine, Professor Procaccia offered to add to the existing causes of circumventing the law and creditors' deceit an independent cause of undercapitalization, as well as introduction of the doctrine of equitable subordination.[347] He did not endorse the adoption of the enterprise theory.[348]

The Barak Committee Report and the Companies Bill of 1995 included a specific section, titled "veil lifting," that defines the concept and lists as non-exhaustive examples the cases in which the court may pierce the corporate veil. "Veil lifting" was defined as "the attribution of the company's rights and duties to its shareholder" or "the attribution of a shareholder's traits, rights, and duties to the company."[349] The scenarios for veil piercing included cases where there exists a statutory stipulation, or intent to abuse the law or to deceive or deprive a person.[350] They also recognized subordination of a shareholder's debt.[351] While espousing the general reasoning of Professor Procaccia, the 1995 bill did not adopt undercapitalization as an explicit cause for piercing the corporate veil.[352] This cause was added in the new law's final version.[353] In addition, contrary to Procaccia's proposal that established a closed list of bright line rules, the bill and later the law established an open list of

346. *See* PROCACCIA, *supra* note 7, at 47-51, 155-57.

347. *See id.* at 51-71. Under the doctrine of equitable subordination, the court can treat a shareholder's loan to the company as equity that is subordinated to the debt of all other company creditors.

348. *See id.* at 71-74; HAVIV-SEGAL, *supra* note 344, at 267-69.

349. *See* § 8(a) of the Companies Bill, 1995 (translated freely by author). The official explanation accompanying the bill refers to the attribution of the company's duties and rights to its shareholders as a "real veil piercing" and to the attribution of shareholders' traits to the company as a "fictional veil piercing." It also notes that the scope of the doctrine varies depending on the circumstances, so it can apply to all shareholders or only to some of them. *See* Companies Bill, 1995, at 12.

350. *See* § 8(b)(1),(2) of the Companies Bill, 1995.

351. *See* § 8(b)(3) of the Companies Bill, 1995.

352. It was mentioned in the official explanation as a cause that has been recognized by the judiciary and that would continue to be developed by it. *See* Companies Bill, 1995, at 12.

353. *See* §§ 6(c)(2), (d) of the Companies Law, 1999.

causes for veil piercing, rich with standards that extend judicial discretion on the matter.[354]

Regarding the personal liability of managers and directors, both the bill and the law acknowledge the court's power to pierce the corporate veil towards those persons for the same reasons that it may pierce the corporate veil towards the company's shareholders.[355] Moreover, the law enables the court to restrict the future participation of shareholders or managers and directors, to whom it attributes the company's duties.[356] The official explanation accompanying the bill stresses that the codification of the doctrine of veil piercing is not meant to limit its development by the judiciary, but rather is intended to maintain the courts' ability to continue to do so.[357] This did not prevent the Companies Law (Amendment No. 3), 2005, from confining considerably the contents and the application of the doctrine.[358]

According to the official explanation accompanying the amending bill, some are of the opinion that the formulation of § 6 of the new law is broad and unclear, creating uncertainty and unforeseen risks for the business community.[359] In order to clarify that the legislature did not intend to extend the incidents in which the corporate veil will be pierced beyond existing law, the amending law sets forth a reduced and exhaustive list of cases for piercing the corporate veil, thereby limiting the court's discretion. Along these lines, it provides that piercing the corporate veil, in the case of undercapitalization, will occur only when the company, through its authorized organs, acted in a way that harms

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354. *See* Procaccia, *supra* note 187, at 315-18. *Inter alia*, the court is authorized to pierce the corporate veil in circumstances where it is "just and fair" to do so. *See* § 8 of the Companies Bill, 1995; § 6 of the Companies Law, 1999.

355. *See* § 77(b) of the Companies Bill, 1995; § 54(b) of the Companies Law, 1999. As for the breaching of the company's reporting duties, the law did not follow Professor Procaccia's proposal to impose personal liability on the directors in that case. It settled for the ability to collect "monetary sanctions" from them. *See* § 360 of the Companies Law, 1999.

356. *See* § 7 of the Companies Law, 1999. Under this section, the court may order that, for a period of no longer than five years, the said persons could not act as director or CEO of a company, or be involved in the incorporation or management of a company.

357. *See* Companies Bill, 1995, at 12, 33.

358. *See* §§ 2, 3 & 10 of the Companies Law (Amendment No.3), 2005.

359. *See* Companies Bill (Amendment), 2002, at 640.

the company's interest and involves an unreasonable risk of undercapitalization.[360] Similarly, the amending law changes the predicate of the provision that deals with piercing the corporate veil when there was intent to deprive, from a "person" to a "creditor."[361] The official explanation further details that when allowing for efficiency considerations, the court is to examine the benefit for the economy from the use of the limited liability principle. It goes on to explain that in considering whether it would be "just and fair" to attribute the company's duties to a shareholder, the court should take into account the size of the shareholder's holdings and the fulfillment of the shareholder's duties toward the company. The official explanation suggests that when the size of the shareholder's holdings does not enable it to effectively monitor the company's action, it would not be just and fair to pierce the corporate veil towards such shareholder.[362]

Finally, the amending law abolishes the option of piercing the corporate veil with regard to managers and directors. Nullification of such a doctrine is said to reconcile the accountability of these persons with their duties under the Companies Law, the Companies Ordinance (including § 373 that permits piercing the corporate veil for managers and directors when the company is dissolving), and the general law.[363]

Shareholder Activism

The Companies Ordinance was silent regarding voting by proxy at the general meeting of shareholders.[364] Hence, the general principles of agency applied to the situation.[365] In practice, however, due to the fact

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360. By comparison, the Companies Law did not require an actual harm to the company's interest but just that the management of the company's business was not in the company's interest.

361. The implication is that if the court endorses a formal or literal interpretation of the text, involuntary creditors (i.e., tort claimants) or other third parties may be deprived of a remedy.

362. *See* Companies Bill (Amendment), 2002, at 640. The final version of the amending law further adds a knowledge qualifier in connection with the attribution of the company's duties to a shareholder. *See* § 2 of the Companies Law (Amendment No. 3).

363. *See* Companies Bill (Amendment), 2002, at 640.

364. Although the sample of bylaws in its second appendix enabled the procedure.

365. On the problems ensued from applying general agency principles to the case of shareholders' proxy voting, see PROCACCIA, *supra* note 7, at 297-99; Agmon &

that the ownership of the shares belonged legally to a registration company rather than to the investors, voting of dispersed shareholders, either in person or by proxy, was nonexistent.[366]

The Companies Bill, 1995, established the ownership right of an investor in the shares.[367] Following Professor Procaccia's proposal, it also created a proxy process that regulates voting by proxy and enables shareholder proposals and inspection rights in a manner similar to the American arrangements on the issue.[368] As opposed to Professor Procaccia, however, who suggested making the proxy process permissive,[369] the bill makes it mandatory for public companies.

The Companies Law embraces a limited version of the mechanism set forth by the bill.[370] It confines the subjects on which shareholders of a public company may vote in writing and leaves broad discretion to the Minister of Justice to regulate substantive questions, such as who will bear the costs of shareholder proposals, or which kind of companies will be exempted and which kind of shareholders will be excluded from this voting process.[371] In addition, the mechanism is to become enforceable only after the publication of the regulations regarding its implementation.[372] These were only recently approved by the Knesset Committee.[373]

Finally, according to the new law, a shareholder in a public company who wants to vote in the general meeting must prove to the company its ownership right in the shares in a way decided by the

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Lahman-Messer, *supra* note 340, at 565.

366. *See* Agmon & Lahman-Messer, *supra* note 340, at 562-65 (discussing the causes for market failure in the voting process in the general meeting of shareholders and the need for creating a mechanism that mitigates this failure).

367. *See* Companies Bill, 1995, §§ 206-07.

368. *See* PROCACCIA, *supra* note 7, at 297-302; the Companies Bill, 1995 §§ 107-17. *See also* Agmon & Lahman-Messer, *supra* note 340, at 565-69.

369. PROCACCIA, *supra* note 7, at 295-97.

370. *See* Companies Law, 1999 §§ 87-89.

371. According to § 89 of the Companies Law, 1999, in regulating this issue the Minister of Justice should consult with the Minister of Finance and the SEC.

372. *See* Companies Law, 1999, § 377(1).

373. *See* THE SUBCOMMITTEE OF THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, 16TH KNESSET, 4TH SESS., PROTOCOL NO. 603 (Nov. 1, 2005) (discussing the Companies Regulations (Postal Vote and Policy Statements), 5765-2005).

Minister of Justice.[374] This ownership is usually registered with an exchange member.[375] The regulations enacted on the matter require ownership authorization by the exchange member.[376] They are silent, however, regarding the costs of the procedure. The official explanation to the Companies Bill (Amendment), 2002, suggests imposing the authorization costs on exchange members, in light of practical experience, and limiting their right to indemnification related to such authorization.[377] The rationale is to encourage dispersed shareholders to participate in the decision-making process of the company.[378] The Companies Law (Amendment No. 3) gives the exchange members some leeway in that it provides that the Minister of Justice may determine circumstances in which ownership authorization will be subject to a fee.[379]

Chairperson/CEO

Prior to the enactment of the new law, it had been common practice for public companies in Israel to have their chairperson act as their CEO.[380] Professor Procaccia's proposal reflects the notion that a separation between the monitoring and executive branches of the company is warranted.[381] Although Professor Procaccia suggested an enabling rather than a mandatory arrangement, the content of his proposal was more restrictive than the one eventually adopted. Specifically, he proposed that first, in any company (public or private) that has more than three directors, the CEO would not act as the chairperson; and, second, that in every public company, the chairperson would be elected from among the independent directors.[382] Moreover,

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374. *See* Companies Law, 1999, § 71.

375. *See* Companies Law, 1999, § 177.

376. *See* Companies Regulations (Proving Ownership in a Share for the Purpose of Voting in the General Meeting), 5760-2000.

377. *See* Companies Bill (Amendment), 2002, at 641.

378. *Id.*

379. *See* § 14 of the Companies Law (Amendment No. 3), 2005.

380. The Companies Ordinance did not deal with the issue.

381. *See* PROCACCIA, *supra* note 7, at 250-51; the Companies Bill, 1995, at 52. Both sources note that the notion is drawn from the Government Companies Law.

382. According to the new law, as well as the Ordinance, any public company has to appoint two independent directors for its board. *See* § 239 of the Companies Law, 1999; § 96b of the Companies Ordinance.

he specifically denounced the current practice according to which the chairperson is a paid officer, head of the company's administration.[383]

The 1995 bill states that in a public company the board chairperson will not act as the CEO and will not have the CEO's powers.[384] The new law softens the provision by enabling a company to temporarily override it by complying with a specified procedure. Under § 121(c) of Companies Law, 1999, notwithstanding the said provision, the shareholders at a general meeting may authorize the chairperson to act as the CEO for a period of up to three years, provided that majority vote on such authorization includes the vote of two-thirds of the non-controlling shareholders.

Some scholars have emphasized that the rationale for separating the chairperson from the CEO is an acknowledgment that there is a need to prevent failure by the board to monitor the active management of the public company, where the same individual is the CEO, the chairperson, and sometimes also the control holder.[385] According to the official explanation accompanying the Companies Bill (Amendment), 2002, however, the experience gained since the law came into force, as was reported by different groups (without specification of who these groups were), shows that the current rule set by § 121(c) makes it difficult for companies to approve a decision that authorizes a chairperson to act as a CEO.[386] The difficulty ensues, the explanation proceeds, from the fact that in many cases non-control shareholders are not present in the general meeting.[387] Hence, the amending law extends the override of the prohibition on the chairperson from acting as a CEO also to cases where the number of the dissenting non-control shareholders does not exceed one percent of the overall voting rights in the company.[388] It further

383. *See* PROCACCIA, *supra* note 7, at 251, 193 n.11 (claiming that the phenomenon does not reflect a conscious policy that anyone would defend but rather a practical solution for occupation problems of excellent practitioners and suggesting to immediately abolish this practice).

384. *Cf.* The Companies Bill, 1995, §§ 142(a)(1), 145(b) (as opposed to Professor Procaccia's proposal the bill bans independent directors from serving as the chairperson); *see id.* §§ 142(a)(3), 270(a).

385. *See* GROSS, *supra* note 122, at 119-20, 385.

386. *See* Companies Bill (Amendment), 2002, at 643.

387. *Id.*

388. *See* § 19 of the Companies Law (Amendment No. 3), 2005. The Companies Bill (Amendment), 2002, at 643 states that this 1% rule is similar to the decision rules

clarifies that the general meeting may use § 121(c) repeatedly.

Delegation to Board Committees

The new corporate law establishes the concept of the board as a monitoring rather than a managing body.[389] Put differently, the law acknowledges the importance of the board in solving the agency problem between shareholders and managers.[390] Due to the prominence of the board in making policy decisions and supervising management, the law lists issues that the board cannot delegate to the active management.[391] It further lists issues that the board cannot delegate to its committees, except for recommendation purposes.[392] The criteria regarding this last matter are the danger of a conflict of interest in the board and the significance of the issue. The more specific an issue is and the greater the chances that a committee can mitigate a conflict of interest, the more warranted a delegation to a board committee would be.[393]

Note, in that context, that Professor Procaccia did not elaborate in his proposal on the issues that can or cannot be delegated.[394] Furthermore, he suggested that the law should not include a provision that enables delegation but rather that a company that wishes to delegate powers to a board committee must provide so explicitly in its bylaws.[395] The Barak Committee and the Parliamentary Subcommittee chose the opposite arrangement, according to which delegation is acceptable

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set in §§ 239(b)(2) and 275(a)(3)(b) of the Companies Law, 1999. These sections involve the appointment of outside directors and the approval of conflict of interest transactions, respectively. It is noteworthy that the alternative decision rule set by these sections is the inclusion in the majority vote of only one third of the disinterested shareholders present in the voting, as distinct from the two-thirds requirement of § 121(c).

389. *See* Companies Law, 1999, § 122.

390. *See* PROCACCIA, *supra* note 7, at 195-96; Companies Bill, 1995, at 46-47.

391. *See* Companies Law, 1999, § 92; *cf.* Companies Bill, 1995, § 123. According to the official explanation, the notion of a non-exhaustive list of issues is borrowed from the Governmental Companies Law, 1975. *See id.* at 47.

392. *See* Companies Law, 1999, § 112; *cf.* Companies Bill, 1995, § 139.

393. *See* Companies Bill, 1995, at 51-52.

394. *See* PROCACCIA, *supra* note 7, at 308.

395. *Id.* at 248.

unless the bylaws state otherwise.[396] The significance of this change is that under the latter structure the board committees become the common forum for decision-making.

The amending law reduces the list of the issues that the board cannot delegate to its committees.[397] Specifically, it sets the terms under which the board may delegate its powers to distribute the company's equity to its employees and its subsidiary's employees.[398] The official explanation notes, in this context, the prevalence of the action and the fact that the delegation is subject to a plan outlined by the board.[399] More interesting, however, is another provision that appeared in the earlier versions of the amending bill but was eliminated from its final version, as was approved at first reading by the Knesset, and from the amending law.[400] It had to do with the delegation of the board power to approve financial reports.

According to the official explanation accompanying the bill's initial version, experience shows that there is difficulty in complying with the requirement to have the board approve the financial reports, due to the time pressures and the possible need to reconvene the board at a later date. Nonetheless, the suggested amendment included some checks into the ability of the board to delegate its power of approving financial reports.[401] Finally, on May 19, 2002, following an appeal by the Minister of Finance, the government rejected the Justice Ministry's proposal concerning the delegation of the board's power to approve

396. *See* Companies Law, 1999, § 110; *see also* the Companies Law (Amendment No. 3), 2005, § 21.

397. *See* Companies Law (Amendment No. 3), 2005, § 23.

398. Under § 112 of the Companies Law, 1999, the board is not allowed to delegate its power on this issue to its committees, except for recommendation purposes.

399. *See* Companies Bill (Amendment), 2002, at 642-43.

400. The earlier versions of the amending bill were published on the Justice Ministry's website (on file with author).

401. The original version of the memorandum of the Companies Law (Amendment), 5761-2001, required an authorization in the bylaws to delegate, and that one third of the board members be members of said committee and present at the time the reports were approved. The latter version additionally required that delegation occur only after discussing the reports in the board and for special reasons, and that all the outside directors be members of the said committee. Moreover, it required the distribution of the reports to all members of the board immediately after their approval in the committee.

financial reports.[402]

Shareholders' Duties

The Companies Ordinance did not impose any duties on the company's shareholders except the prohibition to act in a way that oppresses other shareholders.[403] The courts adopted the American doctrine with regard to fiduciary duties that apply to control holders who sell their shares.[404] In addition, the Securities Law, following the Barak Committee's interim recommendations later incorporated in the new law, set a special procedural mechanism for approving irregular conflict of interest transactions between a traded company and its control holder.[405]

Professor Procaccia suggested requiring control holders to exercise their control in good faith and in an accepted way.[406] He further proposed to apply the same duty to any shareholder or constituency member whose actions are pivotal to the company's operation.[407]

The Companies Bill, 1995, extended the duty to act in good faith and with fairness to any shareholder in the company.[408] It also established that a shareholder should avoid using a company business

402. *See* Globes Correspondent, *The Government Set: Only the Board of Directors Will Approve Reports,* GLOBES ELECTRONIC ARCHIVE, May 19, 2002.

403. *See* Companies Ordinance, § 235 (according to the general norm, in exercising its obligations a shareholder should act in good faith and in an accepted way); *see also* The Contract Law (General Part), 1973, §39.

404. *See* C.A. 817/79 Cosoi v. Y.L. Foictonger Bank Ltd., 38(3) P.D. 253 (Isr.).

405. *See* Securities Regulations (Limitations on the Matter of Conflict of Interest between a Listed Company and Its Control Holder), 5754-1994. According to the regulations, these transactions had to be approved through a process that included the board's audit committee, the board, and, in some cases, also the general meeting of shareholders where the support of at least one third of the disinterested shareholders was required. "Irregular transaction" was defined in § 96kd of the Companies Ordinance and § 1 of the Companies Law, 1999 as a transaction conducted not in the ordinary course of business or not under market conditions, or a transaction which may substantially affect the company's earnings, assets or obligations.

406. *See* PROCACCIA, *supra* note 7, at 352-73.

407. *See id.*

408. *See* § 227 of the Companies Bill, 1995. Neither the bill nor the law includes a definition of the fairness duty. The law, however, specifies that a breach of the fairness duty bears the same consequences as the breach of fiduciary duty by a manager or director. *See* § 193(b) of the Companies Law, 1999.

opportunity if it might harm the company.[409] Lastly, the bill adopted a procedural mechanism for approving irregular conflict of interest transactions, not only with regard to control holders but also with regard to any shareholder.[410] According to the official explanation accompanying the 1995 bill, the stricter requirement regarding control holders was not recommended by the Barak Committee but was added to the blueprint based on a joint suggestion by the Justice Ministry and the ISA.[411]

The new law differs from the 1995 bill in four main respects: first, while maintaining the duty of any shareholder to act in good faith and in an accepted way, the law extends the fairness duty only to control holders and shareholders whose vote is decisive.[412] Second, the law omits the duty imposed on shareholders to avoid misusing the company's business opportunities. Third, it applies the procedural mechanism for approving irregular conflict of interest transactions only to control holders rather than to any shareholder.[413] Fourth, instead of exempting from the special approval procedure a defined list of transactions,[414] the law delegates the authority to exempt certain types of

409. *See* § 230 of the Companies Bill, 1995. The bill did not adopt the arrangement suggested by Professor Procaccia as to the allocation of opportunities within a group of related companies. *See* PROCACCIA, *supra* note 7, at 374-81.

410. *See* §§ 231, 232 of the Companies Bill, 1995. Note that the procedural mechanism set by the bill is conditional on the substantial requirement that the transaction does not harm the company's interest. According to § 231, an irregular conflict of interest transaction with a shareholder that does not hurt the company's interest requires the approval of the board; in cases where a majority of the board is interested, additional approval by the audit committee is required; and in cases where a majority of the audit committee is interested, approval by a general meeting, with the support of at least one third of the disinterested shareholders, is required. According to § 232, where the irregular conflict of interest transaction involves a control holder, a tripartite approval process is always required.

411. *See* Companies Bill, 1995, at 72.

412. *See* §§ 192, 193 of the Companies Law, 1999.

413. *See* §§ 270(4), 275 of the Companies Law, 1999. Section 275 enables an alternative to the requirement of the support of at least one third of the disinterested shareholders in the general meeting. It materializes where the number of dissenting disinterested shareholders does not exceed one percent of the overall voting rights in the company.

414. *See* § 233 of the Companies Bill, 1995.

transactions to the Minister of Justice.[415]

According to the Justice Ministry representatives who drafted the law, the said provisions express both the starting point of the economic approach, i.e., a market failure, and the aspiration to create fair provisions that neutralize the fear that the majority will use its power to the detriment of the minority.[416] The specific fairness duty is intended to deal with situations where a significant minority might misuse its power in deciding crucial issues.[417]

Finally, the Companies Law (Amendment No. 3), 2005, offers some apparently cosmetic changes to the list of transactions that require special approvals. Regarding a "material private placement" that necessitates the approval of both the board and the general meeting of shareholders,[418] it replaces the current definition of that term with a narrower one.[419] The current definition of a "material private placement" is "a private placement that will result in increasing the holdings of a material shareholder[420] or in creating a material shareholder." The new definition adds the requirement that the private placement grants at least 20% of the company's voting power and that it is either not under market conditions or that the consideration is not in cash or listed securities.[421] Alternatively, it defines a "material private placement" as a private placement that will result in creating a control holder.[422, 423]

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415. *See* § 284 of the Companies Law, 1999. Comparing the Companies Regulations (Relief in Transactions with Interested Parties), 5760-2000, with the bill's provisions indicates that the regulations are much broader. For a critical review of the regulations, see Prof. Yossef Gross, Adv., *New Reliefs in Approving Transaction With Control Holders*, GLOBES ELECTRONIC ARCHIVE, Feb. 18, 2002.

416. *See* Lahman-Messer & Rosman, *supra* note 326, at 265.

417. *Id.* at 265; Companies Bill, 1995, at 70-71.

418. *See* § 274 of the Companies Law, 1999.

419. *See* § 65 of the Companies Law (Amendment No. 3), 2005.

420. According to § 1 of the Companies Law, 1999, a "material shareholder" is a shareholder who holds at least 5% of the company's shares or voting power.

421. *See* § 65 of the Companies Law (Amendment No. 3), 2005.

422. According to §§ 1, 268 of the Companies Law, 1999, a "control holder" is a person who holds 50% of the means of control in the company, or a shareholder who holds at least 25% of the company's voting power where no one else holds more than 50% of that power.

423. Notice that § 3 of the Companies Regulations (Relief in Transactions with Interested Parties), 5760-2000, already exempts from the special approval process (by the board and the general meeting) private placements that impart less than 20% of the

According to the official explanation accompanying the amending bill, it is suggested to narrow the definition of "material private placement" similarly to the rules of the stock exchanges in the United States and apply it only in special instances where, in addition to the offeree being a material shareholder, there is a significant dilution in shareholders' voting power.[424]

Derivative Suits and Class Actions

The Companies Ordinance did not include any provisions regarding derivative suits or class actions. The derivative suit mechanism was developed by the judiciary, which followed and expanded the English doctrine on the matter.[425] The class action mechanism was erected by general civil procedure and later by the Securities Law that adopted the Barak Committee's interim recommendations.[426] However, due to the lack of incentives for the plaintiff to bring a derivative suit[427] and the courts' restrictive interpretation of the Securities Law's class action provisions,[428] these mechanisms were rarely used.

The new law contains extensive provisions for derivative suits and class actions in both public and private companies.[429] As for derivative suits, following Professor Procaccia's proposal, the right to file a suit is given to any shareholder or director. There is a demand requirement and, contrary to former law, no contemporaneous ownership prerequisite.[430] Interestingly, the Parliamentary Subcommittee extended to creditors the right to file a derivative suit in the specific case of a

company voting power, contingent on their offeree not being a director or a CEO and that they do not result in the creation of a control block.

424. *See* Companies Bill (Amendment), 2002, at 649-50.

425. *See, e.g.*, C.A. 726/74 Neve Yam Hotels of Arsof Beach Ltd. v. Cohen, 30(2) P.D. 517; C.A. 52/79 Sulimani v. Browner, 35(3) P.D. 617; C.A. 273/85 Gil v. Discount Bank for Israel Ltd., 41(2) P.D. 294; C.A. 324/88 Barbalak v. Shavit, 45(3) P.D. 562.

426. *See* § 29 of the Civil Procedure Regulations, 1984; the Securities Law (Amendment No. 9), 5748-1988.

427. For an analytical account of the optimal incentive, see PROCACCIA, *supra* note 7, at 397-400.

428. *See* Goshen, *supra* note 187, at 414-17.

429. *See* Companies Law, 1999, §§ 194-218.

430. *See* PROCACCIA, *supra* note 7, at 400-08.

prohibited distribution.[431]

As for class actions, while the Companies Bill, 1995, adopted the provisions of the Securities Law almost word-for-word,[432] the new law facilitates the submission of these suits, compared to the former arrangement.[433]

Following Professor Procaccia, the Companies Law provides a pecuniary incentive to file both derivative and class action suits to the plaintiff itself rather than to its attorney.[434,435] As opposed to Professor Procaccia's proposal to set the reimbursement at a fixed rate, however, the Barak Committee left the decision whether to grant reimbursement to the plaintiff and the amount of reimbursement to the discretion of the court.[436]

The Companies Law (Amendment No. 3), 2005, provides that the fees of the plaintiff's attorney in a derivative suit will be set by the court and paid by the company unless the court decides for special reasons that the plaintiff should pay its attorney's fees.[437] According to the official explanation, this arrangement is similar to the legal situation in the United States and is required in order to encourage potential plaintiffs to use the tool of the derivative suit.[438]

Independent Directors

As conceded by Professor Procaccia, the most complex and controversial issue regarding the structure of the board is the question of

431. *See* § 204 of the Companies Law, 1999. According to § 301(b), a prohibited distribution is any distribution in breach of the law's provisions with regard to capital preservation.

432. *See particularly* §§ 54b, 54c of the Securities law and §§ 248, 249 of the Companies Bill, 1995.

433. *See* GROSS, *supra* note 122, at 231-36; Goshen, *supra* note 187, at 412-14.

434. *See* §§ 201, 215 of the Companies Law, 1999. Following the Securities Law, the law further sets that in the case of class action the court will set the contingency fee of the plaintiff's attorney. *See* § 214 of the Companies Law, 1999.

435. With regard to class actions the law adopts another incentive, that is, a possibility that the ISA will fund the suit, under certain conditions. *See* § 209 of the Companies Law, 1999. This incentive is taken after § 54g of the Securities Law.

436. *See* Procaccia, *supra* note 187, at 312-15.

437. *See* § 44 of the Companies Law (Amendment No. 3), 2005.

438. *See* Companies Bill (Amendment), 2002, at 646.

independent directors.[439] The Companies Ordinance, in its 1987 amendment, laid out certain requirements regarding independent directors.[440] It required every public company to appoint at least two independent directors to its board, have at least one independent director on each of the board's committees, and have an audit committee consisting of all the independent directors.[441] An independent director (titled by the Ordinance as "director from among the public") was defined as a resident of Israel who did not have an economic relation to the company or its affiliate(s) and did not have a substantial connection to the company's business management.[442] The Ordinance further established an external statutory committee composed of a judge, the head of the ISA, and the chairperson of the TASE, whose role was to authorize the appointment of independent directors nominated by the company.[443]

After examining the pros and cons of the independent board, Professor Procaccia reached the conclusion that a board of directors that consists only of insiders is prone to creating substantial market failures. Specifically, he explained how the proper functioning of the board and the provision of current and updated information can be seen as a public product, resulting in sub-optimal supervision of the board of directors and aggravation of the agency problem between shareholders and managers.[444] Hence, his model for the public corporation included two alternatives: a board in which the majority of the members are independent; or a board with an all-independent monitoring committee composed of at least three members, having the powers conferred under American law to the audit, compensation, and nominations committees.[445] Moreover, when comparing the suggested model to the

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439. *See* PROCACCIA, *supra* note 7, at 227. See generally GROSS, *supra* note 122, at 261-78 for discussion of the development of the role of the independent director.

440. *See* The Law for Amending the Companies Ordinance (No. 2), 5747-1987. For earlier legislative initiatives on this matter, see PROCACCIA, *supra* note 7, at 227-29.

441. *See* Companies Ordinance §§ 96b, 96if. According to section 96ig of the Companies Ordinance, the audit committee's roles are to review the company's financial situation, internal audit, and business management deficiencies, and to approve conflict of interest transactions.

442. *See id.* § 96b(c),(d). For additional restrictions, see sections 96c-96e.

443. *See* Companies Ordinance § 96f.

444. *See* PROCACCIA, *supra* note 7, at 227-38.

445. *Id.*

arrangement adopted in the Companies Ordinance, Professor Procaccia clarified the inefficiency of the latter in that it enables the *de facto* control of both the board and the audit committee by corporate management.[446] In contrast, the suggested model provides the company with extended flexibility, allowing it to choose among the alternatives while still furnishing it with true monitoring, through either an independent board or through an independent monitoring committee with wider powers than those of the audit committee.[447]

The Barak Committee did not adopt Professor Procaccia's proposal on the matter. Instead, the Companies Bill, 1995, and the Companies Law, 1999, adopted, in lieu of Professor Procaccia's proposal, an arrangement that takes after the Companies Ordinance. The main departure from the Ordinance deals with the appointment process of an independent director (whom the bill and the new law entitled "outside director").[448] According to the official explanation accompanying the Bill, the statutory nominations committee created by the Ordinance experienced difficulty in identifying the relationships between suggested candidates and the public company, and its work resulted in procedural difficulties.[449] Hence, the bill imposed the duty to appoint independent directors on the company.[450] The idea was that this move would prevent companies from using the statutory committee as a rubber stamp.[451] The Companies Law went a step further. It established that the independent directors are to be appointed by the general meeting of shareholders under special rules.[452] Interestingly, a bill submitted to the Knesset by nine MKs in July 2001 suggested reverting back to appointing independent directors by statutory committee.[453]

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446. *See also* Procaccia, *supra* note 7, at 640.

447. *See* PROCACCIA, *supra* note 7, at 238.

448. *Compare* Companies Ordinance *with* Companies Bill, 1995, *and* Companies Law, 1999.

449. *See* Companies Bill, 1995, at 82.

450. According to § 267 of the Companies Bill, 1995, "an outside director would be appointed in the way that was set by the company's bylaws and this law for appointing directors" (translated freely by author).

451. *See* Agmon & Lahman-Messer, *supra* note 340, at 569-71.

452. According to § 239(b) of the Companies Law, 1999, the simple majority in the general meeting has to include at least one-third of the disinterested shareholders. Alternatively, the number of dissenting and disinterested shareholders should not exceed one percent of the overall voting rights in the company.

453. *See* The Companies Bill (Amendment – Outside Director), 5761-2001,

As for other differences occurring during the legislative process, although according to the official explanation the 1995 Bill maintained the qualifying conditions that prohibited any relation between the independent director and the company,[454] the law itself seems to mitigate some of these requirements. Among others, the law abolished the presumption found in the Ordinance and Bill according to which a holding of at least 5% of the company's shares would be seen as a prohibited business relation.[455] It also abolished the limitation set by the Ordinance and Bill with regard to the number of companies for which a person is concurrently allowed to serve as a director.[456]

The Companies Law (Amendment No. 3), 2005, amends the new law in two important respects. On the one hand, it further narrows the list of people who cannot be appointed as independent directors because of their relation to the public company.[457] First, it authorizes the Minister of Justice to exclude certain matters from the definition of a "relation" that disqualifies a person from being appointed as an outside director.[458] In addition, the amendment excludes, without any explanation, members of the ISA and directors of an exchange in Israel (as opposed to employees of these institutions) from the list of people disqualified to serve as outside directors.[459]

Hatza'at Chok No. 2916, submitted to the Knesset Approval on July 24, 2001, *available at* http://www.knesset.gov.il/privatelaw/data/2916.rtf. The bill was rejected on Feb. 13, 2002. *See* THE COMPANIES BILL (AMENDMENT – OUTSIDE DIRECTOR), 5761-2001 (PRIVATE BILL) (NO. 285), D.K. (2002).

454. *See* Companies Bill, 1995, at 82-84.

455. *Compare* Companies Ordinance § 96b(d) *and* Companies Bill, 1995, § 268(b), *with* Companies Law, 1999, § 240(b).

456. *Compare* Companies Ordinance § 96i *and* Companies Bill, 1995, § 273(a), *with* Companies Law, 1999, § 240(c).

457. *See* § 55 of the Companies Law (Amendment No. 3), 2005.

458. To exemplify this point, the official explanation suggests that a person should not be prevented from becoming an outside director of a company controlled by the state just because his or her relative has working relations with the state, which do not raise the danger of a conflict-of-interest. *See* Companies Bill (Amendment), 2002, at 647. Note that section 17a of the Governmental Companies Law, 1975, disqualifies a person whose relative is a director or a CEO or a senior employee of the company from serving as a director. Note further that § 96c(c) of the Companies Ordinance authorized the Minister of Justice to set additional occupations that disqualify a person from being appointed as an independent director.

459. By comparison, § 96c(b) of the Companies Ordinance and § 240(e) of the

On the other hand, following the trend in the United States and other Western countries to strengthen board independence and its ability to oversee the company's performance, the amending law provides that at least one of the outside directors appointed by a public company should have accounting and financial expertise and that the rest of the outside directors should have a professional qualification.[460]

Managers' and Directors' Duties and Rights

Professor Procaccia's proposal regarding the rights and duties of the company's managers and directors was influenced by the American concepts of these issues.[461] These notions have gradually diffused into Israeli law. In 1984, the Israeli Supreme Court acknowledged the fiduciary duties that managers and directors owe to the company.[462] The independent directors' right to information and experts' aid was added to the Ordinance in 1987.[463] Fiduciary duties, indemnification, and insurance rights became a part of the Ordinance in 1991, following the Barak Committee's interim recommendations.[464] With respect to

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Companies Law, 1999, disqualify members and employees of the ISA as well as members of the board and employees of an exchange in Israel from serving as independent directors.

461. *See* §§ 51, 55 of the Companies Law (Amendment No. 3), 2005. *See also* the Companies Bill (Qualification of Outside Directors), 2004. The amending law provides further that in a public company the board is to determine the minimal number of directors who possess accounting and financial expertise based, among other things, on the type and size of the company, as well as on the range and complexity of its activity. The law clarifies that the appointment of directors who have accounting and financial expertise or a professional qualification does not change the legal liability imposed on such directors or the other directors. *See* §§ 18, 58 of the Companies Law (Amendment No. 3), 2005.

461. *See* PROCACCIA, *supra* note 7 at 319-51, 387-96.

462. *See* C.A. 817/79 Cosoi v. Y.L. Foictonger Bank Ltd., Piskey Din 38(3) 253 (Isr.).

463. *See* Companies Ordinance §§ 96jb, 96jc.

464. *See* The Law for Amending the Companies Ordinance (No. 4) (functionary's accountability), 5751-1991. *See also* The Law for Amending the Companies Ordinance (No. 5), 1991, 5751-1991; The Law for Amending the Companies Ordinance (No. 6), 5752-1992; The Law for Amending the Companies Ordinance (No. 7), 1992 5752-1992. According to Professor Procaccia, the need for early legislation ensued from the fact that some of the issues at stake, mainly the indemnification and insurance of managers and directors, were considered "urgent" in the business community. *See*

fiduciary duties, the Ordinance provided that managers and directors owe the company a duty of care as defined by the Tort Ordinance, and that they should perform their duties with reasonable care and expertise.[465] It further stated that managers and directors owe the company a duty of loyalty and should act in good faith for the benefit of the company and avoid conflicts of interest.[466] Nevertheless, the company could authorize such conflict of interest transactions through a special approval mechanism.[467]

The 1995 bill and the new law largely copy the provisions set forth in the Ordinance with regard to fiduciary duties of managers and directors, and improve the procedural mechanism for approving conflict of interest transactions.[468] However, a provision regarding the duty of loyalty in the special case of affiliated companies, which was suggested by the Justice Ministry in consultation with Professor Procaccia and was added to the Companies Bill, 1995, prior to its approval by the Ministers' Committee for Legislation, was eliminated at the end of the parliamentary process.[469] The only remnant of this provision is the exclusion from the definition of a "personal interest" of a manager or director in a transaction – an interest that necessitates a special approval mechanism for the transaction; a situation where he or she serves on both a company and its fully owned subsidiary.[470] The Companies Law (Amendment No. 3), 2005, further excludes from the above definition

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Procaccia, *supra* note 187 at 320 n.33.

465. *See* Companies Ordinance, §§ 96ke-96kf.

466. *See id.* at § 96kg.

467. *See id.* at § 96kh.

468. *See* Companies Law, 1999, §§ 252-57, 268-84. Similar to the approval mechanism with regard to control holders, conflict of interest transactions with managers and directors should be approved through a process that includes the board, the board's audit committee, the general meeting of shareholders, and, in some cases, also requires the support of at least one-third of the disinterested shareholders or, alternatively, that the number of dissenting disinterested shareholders not exceed one percent of the overall voting rights in the company.

469. *See* Companies Bill, 1995, at 85. According to section 280 of the bill, the office of a manager or director in a number of related companies is not, in itself, a conflict of interest action. In addition, the provision enabled managers and directors to consider the interests of the group of companies, as long as it does not harm the interests of the company on whose board they serve.

470. *See* Companies Law, 1999, § 270(1).

situations where a manager or director in a fully owned subsidiary holds shares or options in the parent company, or where a manager or director serves on a number of fully owned subsidiaries of the same company.[471]

The 1995 bill and the new law also enhance manager and director rights. For example, the law expands the right to information and experts' aid for all directors, not only independent ones.[472] It also gives directors the right to sue in case of a breach of fiduciary duty by a manager or director.[473] Moreover, it enables the company to exempt managers and directors from liability for damages caused by a breach of the duty of care.[474] Note that contrary to the Barak Committee's interim recommendations, this exemption mechanism was rejected by the Knesset when it amended the Companies Ordinance in 1991.[475]

Permissible and Prohibited Distributions

The Companies Ordinance did not explicitly order the preservation of the company's capital, dealing with the issue only sporadically.[476] It established that a dividend can be paid only out of profits and that a company cannot repurchase its own shares.[477]

The Barak Committee and the Parliamentary Subcommittee adopted the general framework proposed by Professor Procaccia, according to which the law should first define the actions that are considered a dilution of the company's capital, be it through dividend, allocation of shares without an appropriate return, or the purchase of shares by the company itself. These will be referred to as a "distribution."[478] Second, the law should establish which distributions

471. *See* § 65 of the Companies Law (Amendment No. 3), 2005.

472. *See* Companies Law, 1999, §§ 265-66.

473. *See* Companies Law, 1999, § 267. In return, the law extends the duty to report any legal breach or harm to business practice from independent directors to all directors. *See* Companies Law, 1999, § 257.

474. *See id* at § 259; *See* Companies Bill, 1995, § 297.

475. *See* Companies Bill, 1995, at 85; GROSS, *supra* note 122, at 296. *Cf.* PROCACCIA, *supra* note 7, at 390-91 (revoking the exemption apparatus set by the Ordinance prior to its amendment in 1991).

476. *See* PROCACCIA, *supra* note 7, at 479-80.

477. *See* Companies Bill, 1995, at 100; § 98 of the sample of bylaws in the Ordinance's second appendix; Companies Ordinance, § 139.

478. *See* Companies Law, § 1, 1999. For the theoretical implications of the term, see PROCACCIA, *supra* note 7, at 480-96.

are permissible and which are prohibited, such as distributions that result in the reduction of the company's capital below a certain threshold set by the law.[479]

It is in the definition of the threshold of the capital that cannot be distributed – i.e. the creditors' minimal safety cushion – that the Barak Committee and later the law diverged from Professor Procaccia's proposal. Professor Procaccia set the threshold on the sum of the company's liabilities and "stated capital," which includes the stock's par value in addition to any portion of the premium that the company did not exclude and any capitalized profits.[480] The Barak Committee chose a more restrictive threshold; that is, the return received from the allocation of the company's shares (including the premium) and any profits that were capitalized.[481]

In addition, contrary to Professor Procaccia's proposal that the law clearly define that funds can be distributed, the 1995 Bill and the new law settled for a reference to "accepted accounting rules" in defining distributable profits, thereby causing the courts to rely upon the testimony of experts in this field rather than on bright line rules.[482]

Lastly, while the Barak Committee embraced the two additional requirements offered by Professor Procaccia for capital preservation purposes, namely solvency and liquidity,[483] the new law eliminates the liquidity test and delegates to the Minister of Justice the authority to set legal presumptions and exemptions with regard to permissible distributions.[484]

As for the liability of directors with regard to prohibited distributions, the 1995 Bill and the new law adopted the arrangement offered by Professor Procaccia.[485] According to this arrangement, the relevant basis of accountability in the case of a prohibited distribution is

479. As mentioned above, under section 301(b) of the Companies Law, a prohibited distribution is any distribution in breach of the law's provisions with regard to capital preservation.

480. *See* PROCACCIA, *supra* note 7, at 508-13.

481. *See* Companies Bill, 1995, at 101.

482. *See* Procaccia, *supra* note 187, at 318-19; PROCACCIA, *supra* note 7, at 500-03.

483. *See* PROCACCIA, *supra* note 7, at 503-08; Companies Bill, 1995, at 101.

484. *See* Companies Law, 1999 § 302.

485. *See* PROCACCIA, *supra* note 7, at 519-21; Companies Bill, 1995, § 359; Companies Law, 1999, § 311.

guilt. However, in cases where the director opposed the distribution and did all that could be done to prevent it, where the director relied in good faith on misleading information that would otherwise warrant the distribution or where he or she did not know and did not have reason to know about the distribution, the presumption of breach of duty of loyalty would not apply.[486]

The Companies Act (Amendment No. 3), 2005, diverges from the current provisions in that it extends the legal presumption regarding the type of duty breached in the case of a prohibited distribution to also include a duty of care.[487] It ensures, however, that in this case, companies will not be able to exempt a director in advance from liability.[488] According to the official explanation accompanying the amending bill, situations may arise where a prohibited distribution is the result of breaching a duty of care rather than a duty of loyalty.[489] Thus, it is suggested to leave the decision to the court in specific cases. The upshot, the explanation proceeds, is that a company would be able to insure against a manager or director breaching a duty of care in the case of a prohibited distribution.[490] However, in this case, creditors are protected despite a reduction in their safety cushion since a company is prevented from exempting a director from liability.[491]

The Regulation of the Market for Corporate Control

Mergers and acquisitions issues were only dealt with partially and indirectly by the Companies Ordinance. Following the old English model, mergers were governed by general provisions of "compromise and settlement" that were not apt to accommodate modern merger law.[492] Since 1994, tender offers in traded companies were governed by the Securities Law, which among others prohibited the adoption of

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486. *See id.*

487. *See* § 74 in the Companies Law (Amendment No. 3), 2005.

488. *See* § 59 of the Companies Law (Amendment No. 3), 2005.

489. *See* Companies Bill (Amendment), 2002, at 648.

490. This was not possible otherwise, since the duty of loyalty is usually not insurable. *See* Companies Law, 1999, § 261.

491. *See* Companies Bill (Amendment), 2002, at 648.

492. *See* Companies Ordinance §§ 233, 234, 236. For an elaborate analysis of these provisions, see Yedidia Z. Stern, *Merger of Companies In Israel*, 20 MISHPATIM 73, 99-109 (1990).

poison pills once an offer has been made and regulated freeze out mergers.[493]

Professor Procaccia's proposal included comprehensive and detailed legal requirements for corporate acquisitions.[494] Guided by the goal of economic efficiency, and assuming that the company's shares were widely held prior to the acquisition, Professor Procaccia advocated the regulation of any acquisition resulting in *de facto* control.[495] More specifically, his proposal prohibited the acquisition of *de facto* control in a company in ways other than through a merger or tender offer. For example, obtaining control through piecemeal purchase of shares was prohibited. These provisions were attributed to the alleged negative effect of such purchases on shareholders who were not a party to the transactions and who found themselves in the position of minority shareholders[496] Professor Procaccia's proposal facilitated mergers, including statutory mergers,[497] and offered a new model for takeovers based on the unforced acceptance of offers by the majority of the shareholders.[498] It also regulated freeze out mergers in cases of forced sales of shares to control holders by granting appraisal rights to minority shareholders holding less than 10% of the company's shares.[499] Finally, based on the assumption that no market failure exists in this situation, the proposal does not regulate the private sale of control.[500]

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493. *See* Securities Regulations (Tender Offer), 5754-1994. Following the enactment of the new law, these regulations were replaced by the Securities Regulations (Tender Offer), 5760-2000.

494. *See* PROCACCIA, *supra* note 7, at 565-91.

495. *See id.* at 566-70. *De facto* control was defined as the holding of at least 25% of the company's overall voting rights. *See* Companies Law, 1999, § 1.

496. *See* PROCACCIA, *supra* note 7, at 585-87.

497. *See id.* at 571-76.

498. *See id.* at 576-85. The takeover model was jointly formed by Professor Procaccia and Professor Lucian Bebchuk and inspired by Lucian A. Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1693 (1985). As mentioned by Professor Procaccia, the Israeli arrangement uses the notion of a second opportunity to accept rather than the two-tiered voting procedure offered by Professor Bebchuk. *See* Procaccia, *supra* note 7, at 645 n.55.

499. *See* PROCACCIA, *supra* note 7, at 588-90. Interestingly, Professor Procaccia seems to later on change his mind. In a recent article, he described the freeze out merger mechanism of the new law and criticized its appraisal remedy. *See* Procaccia, *supra* note 187, at 323-26.

500. *See* Procaccia, *supra* note 7, at 637-38.

The Barak Committee widely embraced Professor Procaccia's proposal.[501] For example, it adopted a rule according to which the shareholders' vote on a merger or tender offer cannot include the votes held by the offeror.[502] According to Professor Procaccia, notwithstanding the contrary common law tradition, this rule is warranted since the vote of an offeror (or its control holder) has an inherent conflict of interest and does not carry any informative value.[503] In two respects, however, the Barak Committee diverged from Procaccia's proposal. First, it enabled a creditor of the company to petition the court to delay or prevent a merger.[504] Second, it extended the appraisal right of minority shareholders to any case of a merger or tender offer by an existing control holder.[505]

The Parliamentary Subcommittee substantially revised some of the 1995 Bill's provisions. With regard to mergers the new law requires approval of the merger by the boards of those companies in addition to the approval by the shareholders in each of the merging companies. Board approval would not be given if a reasonable doubt exists with regard to the solvency of the acquiring company following the merger.[506] In addition, a merging company would be required to send the merger proposal to its secured creditors and notify its unsecured creditors.[507] Similar to the 1995 Bill, the new law enables creditors to oppose the merger by applying to the court.[508]

With regard to takeovers, the new law narrows down the requirement that acquisitions of a control block be conducted exclusively by way of a tender offer.[509] It applies the provision to only

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501. *See* Companies Bill, 1995, §§ 362-96 and the accompanying official explanation, *id.* at 104-14.

502. *See* Companies Bill, 1995, §§ 369, 380, 390 .

503. *See* PROCACCIA, *supra* note 7, at 571-72.

504. *See* Companies Bill, 1995, § 364 .

505. *See id.* § 392. In the case of a freeze out merger, the bill granted only the offeror the right to apply to the court in the case of dissenting minority shareholders. *See* Companies Bill, 1999, § 393.

506. *See* Companies Law, 1999, §§ 314-15.

507. *See id.* § 318. *See also id.* § 325 (regulating the issue of floating liens of the merging companies).

508. *See id.* § 319.

509. It is noteworthy that although the official explanation accompanying the Companies Bill, 1995, at 108, explicitly stated that the legal arrangements regarding tender offer will only apply to situations where prior to the acquisition the company did

two cases: where no other person already holds a control block, or where as a result of the purchase, the holdings of the acquirer will exceed 45% and no other shareholder holds more than 50% of the company's voting rights.[510] In addition, the law explicitly exempts from the application of this provision the purchase of shares in a private placement.[511] It also conditions a special tender offer on the acquisition of at least 5% of the company's voting rights.[512] As for poison pills, the new law adopts the arrangement in the 1995 bill, under which managers and directors are limited to negotiating the improvement of a tender offer or searching for a "white knight."[513] The new law omitted Professor Procaccia's proposal, however, to ban specific actions, so as to reduce deliberation regarding the purpose of the action (prohibited defensive tactic or permissible business action) that was part of the 1995 Bill.[514]

With regard to shareholder votes on mergers or tender offers, the new law follows the 1995 Bill in that the votes of each participant in the merger (or its control holder) in the case of a merger, and the votes of the offeror (or its control holder) in the case of takeover, not be included in the shareholders' vote.[515] Finally, the new law provides for appraisal rights for minority shareholders only in the case of a freeze out merger,

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not have a control holder, section 394 of the bill prohibited any acquisition of a control block other than in the way of a merger or tender offer, regardless of whether prior to such acquisition the company was controlled by a control holder.

510. *See* Companies Law, 1999, § 328(a). The law refers to this arrangement as a "special tender offer".

511. *See id.* § 328(b). Although not clearly stated, it seems that the section also meant to exempt the private acquisition of control. *See* Companies Bill, 1995, at 107; GROSS, *supra* note 122, at 373. *But see* Goshen, *supra* note 187, at 402-03 (asserting that the requirement of a special tender offer applies also to private purchasing transactions).

512. *See* Companies Law, 1999, § 332.

513. *See id.* § 330.

514. *See* PROCACCIA, *supra* note 7, at 582-83; Companies Bill, 1995, § 384. Note that as opposed to the Securities Regulations (Tender Offer), 5754-1994, that included a similar provision, the Securities Regulations (Tender Offer), 5760-2000, which replaced them, do not. *See also* Goshen, *supra* note 187, at 404 n.56 (stating that the new regulations omitted the provision with regard to existing control holder's prohibited actions).

515. *See* Companies Law, 1999, §§ 320, 331. *See also* Goshen, *supra* note 187, at 406 n.64 (suggesting that although not stated explicitly in the law, the same rule applies to the case of a tender offer that may result in a freeze out merger).

i.e. the forced sale of shares to a control holder who holds more than 90% of the company's shares.[516]

The Companies Law (Amendment No. 3), 2005, provides further modifications to the regulation of mergers and acquisitions. For acquisitions of a control block, it clarifies that such an acquisition need not be conducted by way of a tender offer, if it is a private purchase of control.[517] In addition, it requires the acquirer of more than 45% of the company's voting rights to do so by way of a tender offer only if there is no other person who holds the same number of voting rights.[518] According to the official explanation, the rationale is to equate this last situation to the acquisition of a control block where another person already holds a control block in the company.[519]
Moreover, the amending law revises the shareholders' voting rule on mergers, so that shareholders' approval is not required in a fully owned subsidiary merging into its parent. In addition, shareholder approval is not required in a surviving entity if the merger does not involve amending the company's bylaws, if the surviving company does not allocate more than 20% of its voting rights and such allocation would not result in creating a control block, and if no cross ownership exists between the merging companies.[520] The amending law further provides that the mere holding of shares in a merging company that holds shares of the other merging company would not count as a holding in the other company, a holding that bans the shareholder from voting on the merger.[521]

516. *See* Companies Law, 1999, § 338.

517. *See* § 78 of the Companies Law (Amendment No. 3), 2005. As the official explanation stresses, in the case of a private acquisition of control, there is no effect on dispersed shareholders and the control holder still bears duties to the company. *See* Companies Bill (Amendment), 2002, at 651.

518. *See* § 78 of the Companies Law (Amendment No. 3), 2005. The Companies Law, 1999 conditioned the application of the provision on the other person holding more than 50% of the company's voting rights.

519. *See* Companies Bill (Amendment), 2002, at 652.

520. *See* § 75 of the Companies Law (Amendment No. 3), 2005. These revisions were added to the final version of the amending law.

521. *See id.* The official explanation clarifies that when a shareholder in a merging company that controls the other merging company votes to approve the merger in the general meeting of shareholders of the controlling company, its interest is identical to the interest of the other shareholders. Therefore, no indirect holding of the controlled company should be ascribed to such shareholder and the said decision rule should not

B. Interest Groups' Impact on the Israeli Corporate Law and its Implications

This section attempts to trace the influence of interest groups on the outcomes of the new corporate law by analyzing the political dynamics that characterized the different stages of the legislative process. In order to facilitate the analysis, the major modifications that occurred in the course of the legislation discussed above have been grouped according to defining aspects: the transformation of bright line rules into standards; the conversion of enabling provisions to mandatory ones; the inclusion of mitigating provisions; and the delegation of authority to the Minister of Justice.[522]

B.1. The Shift from Rules to Standards

The legal literature has long deliberated the legislature's choice between the use of abstract rules (standards) and the use of bright-line rules (rules). Commonly, standards are defined as giving content to the law *ex post*, whereas rules are defined as *ex ante* law that leaves only factual issues for the adjudicator.[523] The debate over the choice between standards and rules has far reaching economic and moral implications.[524] For example, from an economic point of view, which takes into account legal costs and the extent to which an individual's behavior conforms to the law, the choice between rules and standards should be contingent on the frequency with which the law is expected to apply. The greater the frequency, the more desirable rules tend to be relative to standards.[525] In a similar manner, the choice between rules and standards should also depend upon the question of who is the more efficient producer of laws,

apply. *See* Companies Bill (Amendment), 2002, at 651.

522. For a summary table of the major modifications made during the legislative process, see Appendix C.

523. *See* Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 559-60 (1992).

524. *See, e.g.*, *id.*; Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685 (1976).

525. *See supra* note 523, at 567-77 (basing this conclusion on the notion that rules cost more to promulgate; standards cost more to enforce and rules are easier to comply with).

the legislature or the court.[526] This question, in turn, is a function of the specialization of the court and its accessibility to technical expertise. Thus, if in resolving complex technical issues a specialized court that possesses greater expertise and information than the legislature may reach more educated decisions, the production of laws through standards should be preferable.[527] In contrast, a court that lacks expertise is likely, to the extent possible, to shun from engaging in substantive technical deliberations, making it an inefficient producer of legal precepts.[528]

From a political theory perspective, however, the choice between standards and rules is likely to be affected more by the regulator's institutional dynamics than by plain policy choice.[529] Standards provide courts with wider discretion in resolving disputes compared to rules.[530] With regard to Delaware corporate law, some commentators assert that open-ended legal standards enable Delaware to enhance its competitive advantage over other U.S. states[531] and exploit its market power through price discrimination.[532] These commentators allege that Delaware law is more indeterminate than it could be because of the influence of the corporate bar, judicial preferences, and a court-centered legal culture.[533] In response to these allegations, other commentators emphasize the economic usefulness and superiority of Delaware's judge-made corporate law.[534] These commentators explicitly link the virtues of the

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526. *See* Procaccia, *supra* note 187, at 305-06.

527. *See id.* at 306-10.

528. *Id.*

529. *See* Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U. PA. L. REV. 595 (1995). *See also* Kaplow, *supra* note 523, at 608-11.

530. Kamar, *supra* note 314, at 888-89.

531. *See* Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate law*, 98 COLUM. L. REV. 1908 (1998).

532. *See* Kahan & Kamar, *Price Discrimination*, *supra* note 53, 1232-37 (arguing that the reliance of Delaware law on standards-based tests is one of the features that make it litigation intensive, and that the litigation intensive structure of Delaware law results in social waste).

533. *See* Kamar, *supra* note 531, at 1939-46.

534. *See* Roberta Romano, *The Need for Competition*, *supra* note 51, at 519-26 (2001) (noting, in n. 352, that "the use of a standard is most plausibly integrally connected to the nature of the legal issue to be decided rather than the strategic motivations of adjudicators in relation to chartering revenues"); Leo E. Strine, Jr., *Delaware's Corporate-Law System: Is Corporate America Buying an Exquisite Jewel or a Diamond in the Rough? A Response to Kahan & Kamar's Price Discrimination in*

Delaware model to its specialized judiciary, well developed case law, and predictability.[535]

The empirical evidence from the Israeli case seems to sustain, at least to some extent, the political theory explanation regarding the choice between standards and bright-line rules. Reviewing the modifications made during the legislative process reveals a transformation from bright-line rules to standards in major areas such as piercing the corporate veil;[536] the addition of the fairness duty owed by shareholders towards the company;[537] the reimbursement rate given to the plaintiff in a derivative or class action;[538] and the definition of creditors' minimal safety cushion in the context of prohibited distributions.[539] This shift took place mostly during the deliberations of the Barak Committee. That is, the Barak Committee Report and the Companies Bill, 1995, turned (or extended) the bright-line rules suggested in Professor Procaccia's Proposal into standards, which leave ample discretion to the court.

While in certain contexts, such as fiduciary or fairness duties, the use of standards is considered more efficient and is sometimes inevitable due to the idiosyncratic and infrequent behaviors that fall under these rubrics,[540] the use of standards with regard to other issues is more questionable. When unspecialized courts are authorized to pierce the corporate veil in circumstances where it is "just and fair" to do so, or are required to evaluate expert testimony with regard to complex technical issues such as distributable profits, the resulting law might be unpredictable and inefficient.[541] Similarly, when the setting of the

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the Market for Corporate Law, 86 CORNELL L. REV. 1257, 1272-82 (2001) (questioning the efficiency of adopting bright-line rules for regulating complex human behavior in the context of Delaware's standards-based approach that furnishes workable guidance to practitioners while enabling the flexibility required for economic innovation).

535. *See* Romano, *The Need for Competition*, *supra* note 51, at 520-23; Strine, *supra* note 534, at 1263-64.

536. *See supra* note 354 and accompanying text.

537. *See supra* note 408 and accompanying text.

538. *See supra* text accompanying notes 434-36.

539. *See supra* text accompanying note 395.

540. *See* Kaplow, *supra* note 523, at 599-600; Romano, *The Need for Competition*, *supra* note 51, at 523-24. Note that even in these instances Professor Romano conditions the desirability of the use of standards on the expertise of the court. *See id.*

541. *See* Procaccia, *supra* note 187, at 315-19. *See also* Kaplow, *supra* note 523, at

reimbursement rate in a derivative or class action is left to non-expert courts, which tend to use general principles of justice rather than efficiency considerations that require technical expertise, the plaintiff's incentives to file suits or settle might be non-optimal.[542]

Scrutinizing the Barak Committee's protocols with regard to some of these issues[543] as well as the participant's testimonies in the legislative process makes it safe to assume that the internal dynamics in the Committee and principal differences in doctrinal approaches rather than efficiency considerations, account for at least some of these modifications. In particular, members of the Barak Committee rejected an economic approach in favor of more flexible and pragmatic solutions that leave the development of substantive law to the courts.[544] Still, tracing the existing protocols indicates that the ability of the court to enforce corporate law legislation efficiently was not a factor in choosing between bright-line rules and standards.[545]

These patterns reconcile the notion expressed by Alan Schwartz and Robert E. Scott, according to which legislative bodies produce either

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605 (stating that due to individuals' risk aversion, the value of precision with which laws are actually applied, as well as the value of less expensive legal advice, is greater than it otherwise would be, making rules a favorable option).

542. *See* Procaccia, *supra* note 187, at 312-15. *See also* Interview with Judge Michal Agmon-Gonen, *supra* note 223.

543. As was mentioned above in Part II, a large part of the Barak Committee's protocols consist of digests rather than a word-for-word documentation. However, I was able to locate relatively elaborate protocols on the matters of veil piercing, derivative suit, class action, and capital preservation. *See* THE JUSTICE MINISTRY, THE COMMITTEE FOR THE PREPARATION OF A NEW COMPANIES LAW, MEETING PROTOCOLS (Jan. 20-21, 1989) at 5-14; (Jan. 22-23, 1987) at 10-11, 22-23; (Feb 19-20, 1988) at 27-35 (on file with author).

544. For instance, when debating the matter of piercing the corporate veil, members of the Barak Committee and in particular Chairperson Barak commonly referred to a general "justice" requirement that ought to be left to the discretion of the court. It is noteworthy that the Barak Committee was aware of the difficulty in codifying the matter of veil piercing and the need to adjust the relevant provisions to a changing reality. The use of standards might be seen, in that respect, as a necessary compromise between the desire to codify corporate law and the acknowledgement of the indispensability of its flexibility.

545. *See also* Procaccia, *supra* note 187, at 312 (stating that the deficiency of the Israeli court system in producing efficient corporate laws induced him to include in his proposal bright-line rules, but that the dynamics behind the scenes of the legislative process resulted in the alteration of some of these rules to standards).

rules or standards "in consequence of a particular institutional dynamic and not because of their intrinsic virtues as instruments for social control."[546] Similar to Schwartz and Scott's predictions, on many issues, the Barak Committee appeared to prefer standards to the production of bright-line rules, thereby allowing courts broad discretion to follow their own policy rather than a policy set by the legislature.[547] This propensity can be explained by the common law tradition that characterized the Israeli corporate law prior to its codification,[548] as well as by the general deference given to the judiciary during the legislative process.[549]

Whereas the use of standards in the context of Delaware's specialized court system may have benefited both managers and shareholders by producing predictability and flexibility that encourage business activity, notwithstanding the possible creation of some side benefits to the corporate bar, managers and control holders were the big losers of the shift from bright-line rules to standards in the Israeli context. This can be attributed to the use of standards with respect to

546. *See* Schwartz & Scott, *supra* note 529, at 651. Although Schwartz & Scott's article focuses on private law-making groups, such as the ALI and NCCUSL, and that their membership and procedures result in strong status quo bias and a possible capture by interest groups, its implications may apply also to public legislative bodies, to the extent that those bodies share similar structural features. Moreover, public committees such as the Barak Committee resemble private legislatures at least in the sense that their members are considered to be disinterested experts.

547. *See* Schwartz & Scott, *supra* note 529, at 615-16, 621-24. A more elaborate analysis of the consistency of the structural features of public committees in Israel with the formal model offered by Schwartz and Scott is beyond the scope of this work and will be left for a future time.

548. This tradition is considered to be efficient with regard to different corporate law issues, such as fiduciary obligations. *See* Romano, *The Need for Competition*, *supra* note 51, at 519-20.

549. *See supra* notes 234-36 and accompanying text. Interestingly, in their interviews, some of the participants in the legislative process acknowledged that regardless of the statutory provisions, the ultimate reformer of corporate law would be the court. *See* Interviews with Prof. Uriel Procaccia, *supra* note 192; Shuki Abramovich, *supra* note 297. *See also* Irit Haviv-Segal, *The New Companies Law: the End of the Limited Liability Era?* (Dec. 7, 2003), *available at* http://www.israelbar.org.il (asserting that the review of court decisions regarding veil piercing shows that the increase in the number of cases since the enactment of the new law is not related to the specific contents of the legislative arrangement but rather ensues from the fact that the doctrine was codified).

issues such as veil piercing, shareholder duties, and distribution, which, in an overloaded unspecialized court system has resulted in unpredictability and greater exposure of managers and control holders to liability.[550] The absence of the Association of Publicly Traded Companies and the Manufacturers' Association from the Barak Committee meetings and their later extensive involvement in the Parliamentary Subcommittee's proceedings are consistent with this conclusion.

It should be emphasized that the point of departure for the deliberations of the Parliamentary Subcommittee was the provisions of the Companies Bill, 1995, as rephrased by the Justice Ministry representatives.[551] The original legal arrangements suggested by Professor Procaccia, although available and accessible,[552] were not offered as a viable alternative to the Barak Committee Report. Rather, during the Subcommittee meetings, Professor Procaccia represented the Barak Committee and espoused its decisions. As a result of this situation and the general tendency towards allowing for the court's discretion, in instances where the Parliamentary Subcommittee inclined towards rule-like solutions, it narrowed the already existing standards rather than creating new alternative bright-line rules.[553] These amendments aimed at limiting the court's discretion and were more likely driven by political concerns rather than the efficiency considerations offered by economists for the choice of rules over

550. Part of managers' criticism of the new law has touched exactly upon this point. *See, e.g.*, *Managers Against the Corporate Law*, GLOBES ELECTRONIC ARCHIVE (July 7, 1999); Stella Korin-Lieber, *The Jewish Head Invents Patents*, GLOBES ELECTRONIC ARCHIVE (Dec. 23, 1999).

551. *See* Interview with Eran Rosman, *supra* note 232.

552. *See* PROCACCIA, *supra* note 7.

553. For example, with regard to veil piercing, the Subcommittee limited the general provision set by the Companies Bill, 1995, and enabled the court to pierce the corporate veil only in "exceptional cases" and due to "special reasons." *See* THE SUBCOMMITTEE OF THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, ON THE MATTER OF THE COMPANIES BILL, 5755-1995, 13TH KNESSET, 5TH SESS., PROTOCOL NO. 3, 15, 21-22 (Jan. 14, 1996). Similarly, the fairness duty that was imposed by the Bill on all shareholders was confined by the Subcommittee to control holders and shareholders whose vote is decisive. *See* THE SUBCOMMITTEE OF THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, ON THE MATTER OF THE COMPANIES BILL, 5755-1995, 14TH KNESSET, 2ND SESS., PROTOCOL NO. 14, 2-12 (Aug. 6, 1997).

standards.[554]

Parenthetically, it is noteworthy that the choice between bright-line rules and standards is distinguishable, at least in the analytical sense, from the choice between enabling and mandatory provisions, which are discussed next.

B.2. The Conversion of Enabling Provisions to Mandatory Provisions

In general, modern corporate law is conceived as a standard form contract, which combines permissive mechanisms aimed at lowering transaction costs for various economic players, with regulating mechanisms that are intended to solve structural flaws embedded in the corporate entity.[555] The use in corporate law legislation of mandatory provisions, as opposed to enabling ones, has been widely debated by legal scholars.[556] As was mentioned in the previous part of this paper, the new Israeli corporate law is said to be based on the notion of the autonomy of the private will and, therefore, favors the enabling model of legislation. Under this approach, mandatory rules are justified only to the extent that they are required for the protection of third parties or for the correction of market failures.[557]

When reviewing the modifications to the original draft proposal in the course of the legislative process, it is noticeable that some substantive provisions articulated as enabling or at least as optional in Professor Procaccia's proposal were transformed into mandatory provisions in the Companies Bill, 1995.[558] In particular, this tendency

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554. *Cf.* Kaplow, *supra* note 523, at 599-601 (noting that the choice between rules and standards is one of degree and that the desirability of adopting presumptions or ruling certain options in or out depends upon the frequency of behavior with the relevant common elements).

555. *See, e.g.*, PROCACCIA, *supra* note 7, at 16-17; EASTERBROOK & FISCHEL, *supra* note 40, at 22-35.

556. For a summary of the arguments in the mandatory-enabling debate, see ROMANO, *supra* note 48, at 86-91. *See also* Lucian Arye Bebchuk, *The Debate on Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1395 (1989).

557. *See supra* text accompanying notes 321-25; Agmon & Lahman-Messer, *supra* note 340, at 544-48. *See also* ERAN ROSMAN, SHAREHOLDERS IN THE COMPANY – A BUSINESS COOPERATION IN THE FACE OF THE COMPANIES LAW, 1999, 29-33 (1999).

558. Indeed, that was one of the main critiques of the 1995 Bill. *See* Yadlin, *supra* note 185 (demonstrating three faults of mandatory corporate law legislation: an

was evident in the issues of voting by proxy;[559] the separation between the chairperson and the CEO of the company;[560] conflict of interest transactions;[561] and independent directors.[562]

An examination of the changes discloses a complex political reality rather than pure efficiency considerations. The common denominator of all of them is pressure exerted by MKs and the ISA as a response to market scandals that were uncovered during the 1980s.

In chronological order, the exposure of a lengthy price manipulation scheme in the banks' shares in 1983,[563] together with other scandals that involved inflated salaries and theft by bank managers, including Bank Leumi, the second largest bank in Israel, resulted in extensive media coverage and an outcry for governmental involvement in the capital market.[564] One of the reactions was a bill initiated by MK Ariel Weinstein[565] that created the legal institution called "director from among the public."[566] The bill was incorporated in the Companies Ordinance as an amendment in 1987.[567] When the Barak Committee

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inefficiency caused by inflexibility; costs and wastefulness that are the result of contracting around mandatory provisions; and the difficulty it raises for Israeli companies that are listed abroad).

559. *See supra* text accompanying notes 367-69.

560. *See supra* text accompanying notes 380-84.

561. *See supra* notes 410-11, 383 and accompanying text.

562. *See supra* text accompanying notes 439-53.

563. *See supra* note 105 and accompanying text.

564. *See id.*

565. The late MK Weinstein, who was a member of the Knesset during its 10th to 13th sittings, was a member of the Likud, the major right wing party in Israel. The Likud first came to power in 1977 after 29 years of Labor domination. The involvement of MK Weinstein in corporate law legislation can be seen as part of a greater move of Likud MKs towards getting a foothold in the Israeli economy that was previously associated with the labor party. Moreover, MK Weinstein's background as an economic reporter and editor of economic journals, together with his membership of the Knesset's Economics Committee, made him well versed in the subject matter of the proposed legislation.

566. *See* BILL FOR AMENDING THE COMPANIES ORDINANCE (NO. 2), 5746-1986 (FIRST READING) (NO. 282), D.K. (1987). Prior to this initiative, the issue was regulated by the TASE rules, which required traded companies to appoint to their boards at least one director who is not related to the control holders of the company.

567. *See* The Law for Amending the Companies Ordinance (No. 2), 5747-1987. Note that under Israeli law, a bill that is initiated by an MK rather than by the government is referred to as a "private bill" and is required to pass a "primary reading" by the Knesset prior to entering a tripartite legislative procedure, similar to the one

discussed the issue of independent directors, it did so in light of this provision.[568] Notwithstanding the acknowledgment of the deficiencies of the statutory arrangement, the Committee decided to accept the amendment as an existing fact and settle for working on its improvement.[569] Regardless of the call of the ISA Chairperson for a timely amendment, the Justice Ministry officials and Chairperson Barak were inclined towards revising the arrangement as part of the final report of the Committee.[570]

The same market realities described above were the driving force behind the regulation of conflict of interest transactions. In this case, however, the dynamic was more complex. Once again, it began with a bill initiated by MK Weinstein. The bill raised the issue of indemnification and insurance and was proposed in response to the exposure of managers and directors to fiduciary duties.[571] Prior to the submission of the bill to a "primary reading" in the Knesset,[572] the Barak Committee took it upon itself to create and pass as an amendment to the Companies Ordinance an entire chapter that deals not only with the rights but also with the duties of managers and directors.[573] It therefore regulated the issue of indemnification and insurance and, for the first time, codified the issue of fiduciary duties, making the Weinstein bill redundant.[574]

While deliberating the issue of fiduciary duties, the Barak

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applied to governmental bills.

568. For the contents of the arrangement, see *supra* text accompanying notes 440-43.

569. *See* THE JUSTICE MINISTRY, THE COMMITTEE FOR THE PREPARATION OF A NEW COMPANIES LAW, MEETING PROTOCOL (Jan. 22-23, 1987) at 26-34 (on file with author).

570. *See* THE JUSTICE MINISTRY, THE COMMITTEE FOR THE PREPARATION OF A NEW COMPANIES LAW, MEETING PROTOCOL (May 26, 1989) at 1-4 (on file with author). *See also* Interview with Arie Mientkavich, *supra* note 125.

571. *See* Interview with Prof. Joseph H. Gross, *supra* note 224 (noting the *Cosoi Case* where the Israeli Supreme Court, referring to American law, imposed fiduciary duties on managers and control holders, and the Delaware Court decision in *Smith v. Van Gorkom*).

572. *See supra* note 567.

573. *See* Interview with Davida Lahman-Messer, *supra* note 223.

574. *See* THE JUSTICE MINISTRY, THE COMMITTEE FOR THE PREPARATION OF A NEW COMPANIES LAW, MEETING PROTOCOLS (Feb. 19-20, 1988) at 1-16, (Mar. 18-19, 1988) at 1-32 (on file with author).

Committee was reacting to a number of high-profile conflict of interest transactions that took place in the market at that time.[575] Against this background, the Committee's recommendations included an elaborate mechanism for approving conflict of interest transactions that involves the approval of the transaction by the board, the board's audit committee, the general meeting of shareholders and also, in some cases one-third of the disinterested shareholders.[576] This mechanism, and specifically the disinterested shareholder requirement, was considered necessary by the ISA due to the highly concentrated ownership structure of Israeli companies and the danger of the possible looting of companies to the detriment of the minority shareholders.[577]

The interim recommendations of the Barak Committee regarding managers' and directors' duties and rights were added as an amendment to the Ordinance in 1991, and in 1994 the mechanism for approving conflict of interest transactions was applied to control holders through the Securities Law.[578] These interim recommendations, including the ones that were not endorsed by the Knesset when it legislated the amendments, were incorporated into the Companies Bill, 1995.[579] In addition, due to the recommendations of the Justice Ministry and the ISA, the 1995 bill included stricter requirements with regard to control holders than those proposed by the Barak Committee.[580]

Lastly, the preclusion of the chairperson from acting as the company's CEO was influenced by existing legal provisions regarding

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575. *See* Interviews with Davida Lahman-Messer, *supra* note 223; Judge Michal Agmon-Gonen, *supra* note 203. Prior to the Barak Committee's interim recommendations, these transactions were regulated by the TASE and reported to the ISA.

576. For a description of the mechanism, see Procaccia, *supra* note 187, at 320-23.

577. *See* Interviews with Arie Mientkavich, *supra* note 125; Dr. Shimon Wise, *supra* note 125.

578. *See* The Law for Amending the Companies Ordinance (No. 4) (functionary's accountability), 5751-1991; the Securities Regulations (Limitations on the Matter of Conflict of Interest between a Listed Company and Its Control Holder), 5754-1994. *See also* the Law for Amending the Companies Ordinance (No. 5), 5751-1991; The Law for Amending the Companies Ordinance (No. 6), 5752-1992; The Law for Amending the Companies Ordinance (No. 7), 5752-1992.

579. *See supra* text accompanying notes 468-70; Interview with Judge Michal Agmon-Gonen, *supra* note 203.

580. *See* Companies Bill, 1995, at 72; Agmon & Lahman-Messer, *supra* note 340, at 550.

government companies and banks.[581] Although the theoretical and practical question of the efficacy of the separation between the chairperson and the CEO was debated until the final meeting of the Barak Committee, the possibility of making the arrangement enabling rather than mandatory was not considered by the Committee as a feasible option.[582] Similarly, the issue of voting by proxy was regarded as a solution for a market failure that is inherent in the voting process in public companies and as such, required a mandatory intervention.[583]

The political science literature's analysis of the effect of salience on legislation helps explain the conversion of different enabling provisions into mandatory ones. The legislation in these instances was a response to well-reported market crises, as well as to the influence of regulatory agencies, such as the ISA. More specifically, the Israeli experience shows that once market scandals make the front page of the newspaper and are put on the public agenda, the legislature will react.[584] That is, when a major problem is recognized, regulation will follow.[585]

What is more interesting, however, is that the implications of the regulation as well as its efficiency seem to be ancillary to the legislative act itself. In the context of corporate law, this notion means that when a crisis arises, the emphasis of market failures might be a pretext for increasing mandatory regulation.[586] Indeed, the market scandals of the

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581. *See* § 24(b) of the Government Companies Law; BANK OF ISRAEL, THE SUPERVISION OF BANKS, PROPER CONDUCT OF BANKING BUSINESS REGULATIONS, Regulation No. 301-17(c), *available at* http://www.bankisrael.gov.il/deptdata/pikuah/nihul_takin/eng/main.htm. *See also* Interview with Saul Bronfeld, *supra* note 74 (noting that the banks' regulations were in response to the crisis that followed the exposure of the price manipulation scheme in the banks' shares).

582. *See* Letter from Michal Agmon to Members of the Barak Committee (Mar. 3, 1994) (on file with author); Interview with Judge Michal Agmon-Gonen, *supra* note 203.

583. *See* Agmon & Lahman-Messer, *supra* note 340, at 561-69.

584. On the other hand, as discussed later in this part, once the media turmoil dissipates, different groups act to reshape and mitigate the legal arrangements in order to preserve some of their interests. *See infra* Part III.B.3.

585. The Enron episode and the resulting Sarbanes-Oxley Act of 2002 are perfect examples to illustrate this point. Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1523 (2005). *See also* Roe, *supra* note 54, at 2528-30 (noting scandals as the most important trigger for federal intervention in corporate law).

586. *See* Interviews with Davida Lahman-Messer, *supra* note 223 (noting that the

1980s, the active participation of the ISA representatives in the Barak Committee meetings since 1987, and the responsiveness of the Committee to legislative initiatives by MKs resulted in a bill that includes many more mandatory provisions than the proposal on which it was based.[587] In addition, in some instances where the Barak Committee endorsed permissive provisions or avoided regulation altogether, mandatory provisions were imposed through the conduit of securities regulation or related laws.[588] It is noteworthy that the involvement of the ISA with corporate law legislation continued during the Parliamentary Subcommittee meetings as well as in the post-enactment period.[589]

To the extent that mandatory regulation educates the market and improves the accountability of managers and directors, such regulation may be warranted. In a market where no other mechanisms exist, it may even be crucial.[590] However, when such regulation discourages the

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final product of the legislation is mandatory to a greater extent than Professor Procaccia's proposal since it responds to more market failures than the ones Professor Procaccia was willing to acknowledge); Judge Michal Agmon-Gonen, *supra* note 203 (mentioning that the mandatory legislation was the outcome of the prevalent perception at the time when the legislative process took place, according to which, both shareholders and managers are indecent).

587. This is not to say that either Professor Procaccia's proposal or the Companies Bill, 1995, are normatively superior. My claim here is only that the shift from enabling to mandatory arrangements was driven, at least partially, by political realities.

588. The reference here is primarily to the issue of "one share, one vote." While the 1995 Bill and the Companies Law allow the issue of shares with different voting rights, the Securities Law proscribes this practice. *Compare* the Companies Bill, 1995, § 327, *and* the Companies Law, 1999, § 285, *with* the Securities Law § 46b. For the theoretical, practical, and political aspects of the debate, *see* Procaccia, *supra* note 7, at 635-37; Interviews with Arie Mientkavich, *supra* note 125; Saul Bronfeld, *supra* note 125. *See also* THE SUBCOMMITTEE OF THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, ON THE MATTER OF THE COMPANIES BILL, 5755-1995, 13TH KNESSET, 5TH SESS., PROTOCOL NO. 1, 6-7 (DEC. 24, 1995) (as part of his statement to the Subcommittee, Professor Procaccia discussed the issue of "one share, one vote" and summed up with the words, "this is a war in which we [the Barak Committee] fought, and we lost.") (translated freely by author). Another important provision that was initiated by the ISA compels managers of mutual funds to participate and vote in the general meetings of companies whose shares they hold if the issue decided on might harm the interest of the fund's unit holders. *See* § 77 of the Joint Investment Trust Law, 1994.

589. *See infra* notes 662-69 and accompanying text.

590. *See* Interviews with Judge Michal Agmon-Gonen, *supra* note 203 (asserting that since the amendment of the Companies Ordinance with regard to fiduciary duties,

development of competition among companies' bylaws and other market mechanisms, and specifically when the circumstances are such that it makes the regulation more susceptible to interest group pressures,[591] there is a danger that once the media amplifier has died out, different groups that were affected by the mandatory regulation will act in order to reverse or mitigate the effect of the regulation in ways that might prove more harmful than the original flaws the mandatory regulation was intended to overcome.[592] The next subsection examines these trends.

B.3. Mitigating Provisions

As mentioned in Part II, the business sector's main criticism of the 1995 Bill and the Companies Law, 1999, was with its ostensibly over-regulatory nature.[593] Professor Procaccia addressed this criticism at the first meeting of the Parliamentary Subcommittee. After presenting the general principle of freedom of contract and regulatory intervention that is limited to situations of market failure, he continued:

> However, there are more than a few cases . . . in which we [the Barak Committee] intervened and here the burden of proof is on us to explain with regard to each and every case why we chose to

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directors became more professional and accountable); Davida Lahman-Messer, *supra* note 223 (noting that this amendment was initiated by market demand and that nowadays people do not realize how it was possible to live without it).

591. *See* Interviews with Judge Michal Agmon-Gonen, *supra* note 203 (noting that starting with the amendment of the Companies Ordinance with regard to fiduciary duties, interest groups "discovered" the Barak Committee. Although not allowed to participate in the Committee meetings, they would communicate their comments to the Justice Ministry representatives and later took an active role in the Parliamentary Subcommittee's deliberations).

592. In a Conference of the Center for Ethics held in conjunction with the Association of Publicly Traded Companies on the matter of "the Board of Directors' failure" that was held in Jerusalem on Mar. 31, 2003, Saul Bronfeld, the Managing Director of the TASE, stated that "we are dealing with a sophisticated community of business persons and accountants that are able to overturn any regulation" (translated freely by author). *See A Summary of a Conference Day "The Board's Failure"*, THE ASS'N OF PUBLICLY TRADED COMPANIES, BACKGROUND MATERIALS, Apr. 3, 2003, *available at* http://www.e-good.org.il/materials/research.asp?ID=4&linkA=material.

593. *See supra* text accompanying notes 185-86.

> intervene. I allow myself to assume that a large part of the debates that will take place here, in the Constitution Committee, will deal specifically with this matter. Because if we chose not to intervene, I do not imagine that a lot of pressure groups, legitimate interests, will say: "why did you decide not to intervene, please do."[594]

Interestingly, most modifications made to the 1995 Bill, to the Companies Law, 1999, and later to the Companies Bill (Amendment), 2002, did not directly convert mandatory provisions into enabling ones but rather alleviated certain legal arrangements, and made others disappear altogether. Considering that the basis for the Subcommittee's discussions was the Companies Bill, 1995, that Professor Procaccia's original proposal was no longer on the agenda, and that the legal provisions set by the Subcommittee were the outcome of concessions among the different interests involved in the process, this tendency is quite self-explanatory. The processes that led to the Companies Law, 1999, and post-enactment developments are discussed in turn.

(a) The Parliamentary Subcommittee's Proceedings

During the Parliamentary Subcommittee meetings, the shift towards mitigating provisions was prevalent in the fields of voting by proxy,[595] the separation between the chairperson and the CEO,[596] shareholder duties,[597] and the qualifications of independent directors.[598]

From the Subcommittee's protocols and interviews with the participants in the process, it can be deduced that this mitigating mechanism was used by different groups to preserve some of their interests, marginalized in the previous stage of the legislative process. For example, limiting the proxy mechanism to postal vote and policy statements was the result of an understanding between the Justice Ministry, the TASE, and the Association of Publicly Traded Companies with regard to the costs of the mechanism.[599] The separation between

594. *See* THE SUBCOMMITTEE OF THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, ON THE MATTER OF THE COMPANIES BILL, 5755-1995, 13TH KNESSET, 5TH SESS., PROTOCOL NO. 1, 8 (Dec. 24, 1995) (translated freely by author).

595. *See supra* text accompanying notes 370-71.

596. *See supra* text accompanying notes 384-88.

597. *See supra* notes 408-11 and accompanying text.

598. *See supra* text accompanying notes 454-456.

599. *See* Interview with Judge Michal Agmon-Gonen, *supra* note 203; THE

the chairperson and the CEO was an initiative of the Manufacturers' Association.[600]

On other issues, like shareholder duties, conflict of interest transactions or the qualifications of independent directors, the legal arrangements in the Companies Law of 1999 are a compromise between the ISA and the Association of Publicly Traded Companies, in which the Justice Ministry acted as a mediator.[601]

It is important to note that on some matters the Justice Ministry representatives presented to the Parliamentary Subcommittee, legal arrangements that differed substantially from the 1995 Bill represented a starting point. That was the case with regard to loyalty duties by related companies,[602] the omission of the liquidity test with regard to capital preservation,[603] and the chapter on mergers and acquisitions.[604] While some of these issues were hotly debated in the course of the subcommittee meetings, their core remained intact.

Specifically, on the issue of related companies, the Subcommittee and later the Constitution, Law, and Justice Committee accepted the Justice Ministry's opinion that the issue could not currently be regulated due to the difficulty in defining the concept of related companies.[605] On

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SUBCOMMITTEE OF THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, ON THE MATTER OF THE COMPANIES BILL, 5755-1995, 14TH KNESSET, 2ND SESS., PROTOCOL NO. 11, 24-30 (June 18, 1997).

600. *See* Interview with Omri Yadlin, *supra* note 262; THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, 14TH KNESSET, 4TH SESS., PROTOCOL NO. 266, 21-28, 38-39 (Dec. 1, 1998).

601. *See* THE SUBCOMMITTEE OF THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, ON THE MATTER OF THE COMPANIES BILL, 5755-1995, 14TH KNESSET, 2ND SESS., PROTOCOL NO. 14 (Aug. 6, 1997); 14TH KNESSET, 3RD SESS., PROTOCOL NO. 27, 2-44, (Aug. 23, 1998); 14TH KNESSET, 3RD SESS., PROTOCOL NO. 19, 18-33 (Feb. 8, 1998). *See also* Interview with Eran Rosman, *supra* note 262.

602. *See supra* notes 469-71 and accompanying text.

603. *See supra* text accompanying notes 476-77.

604. *See supra* notes 501-08 and accompanying text.

605. *See* THE SUBCOMMITTEE OF THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, ON THE MATTER OF THE COMPANIES BILL, 5755-1995, 14TH KNESSET, 3RD SESS., PROTOCOL NO. 20, 25 (Feb. 19, 1998); 14TH KNESSET, 3RD SESS., PROTOCOL NO. 26, 104-106 (Aug. 13, 1998); 14TH KNESSET, 4TH SESS., PROTOCOL NO. 30, 7-8 (Oct. 27, 1998); THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, 14TH KNESSET, 4TH SESS., PROTOCOL NO. 266, 17-20 (Dec. 1, 1998). For criticism of this decision, see Interviews with Prof. Joseph H. Gross, *supra* note 224; Ruth Shikler, *supra* note 303.

the issue of mergers and acquisitions, the bulk of this chapter was passed rather hastily in a meeting that was chaired by MK Yona Yahav, who substituted for the chairman of the Subcommittee, MK Eliezer Sandberg, and in which both Professor Procaccia and Dr. David Tadmor, then head of the Israeli Antitrust Authority, were active participants.[606] Later endeavors by the ISA to repeal the tender offer requirement in cases where there already exists a control holder, arguing that this requirement discourages takeovers in the concentrated Israeli marketplace, were mostly unsuccessful due to the objections of the Justice Ministry representatives.[607] At the same time, efforts by the Banks' Association to reinforce the status of creditors in the case of mergers, which had been reduced in comparison to the legal situation under the Companies Ordinance, were relatively successful.[608]

(b) Post-Enactment Developments

A major part of mitigating legislative revisions that may be attributed at least in part to interest-group activity occurred after the final approval of the new corporate law by the Knesset in 1999. An investigation into the process that resulted in the Companies Law (Amendment No. 3), 2005, and other related initiatives, can demonstrate the patterns of action that interest groups use and their effect on the Israeli political system.[609]

606. *See* THE SUBCOMMITTEE OF THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, ON THE MATTER OF THE COMPANIES BILL, 5755-1995, 14TH KNESSET, 3RD SESS., PROTOCOL NO. 25, 2-41 (July 21, 1998). *See also* Interview with Eran Rosman, *supra* note 262.

607. *See* THE SUBCOMMITTEE OF THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, ON THE MATTER OF THE COMPANIES BILL, 5755-1995, 14TH KNESSET, 3RD SESS., PROTOCOL NO. 29, 106-116 (Oct. 1, 1998); 14TH KNESSET, 3RD SESS., PROTOCOL NO. 30, 17-20 (Oct. 27, 1998).

608. *See* THE SUBCOMMITTEE OF THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, ON THE MATTER OF THE COMPANIES BILL, 5755-1995, 14TH KNESSET, 3RD SESS., PROTOCOL NO. 24, 34-56 (July 14, 1998); 14TH KNESSET, 3RD SESS., PROTOCOL NO. 25, 2-8, 13, 19-20 (July 21, 1998). *See also* THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, 14TH KNESSET, 4TH SESS., PROTOCOL NO. 266, 14-17 (Dec. 1, 1998) (A suggestion by the Banks' Association to impose on companies a duty to consult with their creditors prior to deciding a merger was rejected by the Committee).

609. As mentioned in Part II, the amending law was passed by the Knesset on March 7, 2005. *See* Companies Law (Amendment No. 3), 2005.

In the last meeting of the Constitution, Law, and Justice Committee that preceded the passing of the new law in the Knesset Plenum, it was agreed that, if necessary, the law would be amended in the near future.[610] This did not prevent certain groups, even prior to the date on which the law became effective, from trying to influence then Prime Minister Ehud Barak to revoke or postpone the application of the new Companies Law.[611]

Once this attempt failed, the Manufacturers' Association dispatched a policy paper to the Prime Minister's office and the Ministry of Finance regarding required revisions to the Companies Law and the Mergers Law in order to make them more suitable for the needs of Israeli high tech companies.[612] The claim was that, without these revisions, high-tech companies would leave Israel and act or incorporate in other jurisdictions.[613] At the beginning of September 2000, following the submission of the policy paper, Prime Minister Ehud Barak convened with the Ministers of Justice, Finance, and Industry, in order to discuss what legal amendments were necessary to induce high-tech companies to stay in Israel. Subsequently, the Justice Ministry drafted a bill

610. *See* Interview with Gad Soen, *supra* note 203; *see also* Interview with Davida Lahman-Messer, *supra* note 223.

611. *See* Stella Korin-Lieber, *The Jewish Head Invents Patents*, GLOBES ELECTRONIC ARCHIVE (Dec. 23, 1999) ("A quiet activity, in which senior officials in the public sector, academia, and the legal-business world are taking part, is occurring these days in an attempt to prevent the full application of the new Companies Law, that is supposed to come into force on February 1. All agree that the law is innovative, creative, and special, but what about the practice? The big fear is that the law will increase the flight of companies out of Israel.") (translated freely by author).

612. The following description is based on Ora Koren, *The Industrials Act to Adapt the Companies Law to High Tech*, HA'ARETZ INTERNET EDITION, Sep. 10, 2000; Ora Koren, *Additional Alterations to the Companies Law: "Piercing the Corporate Veil" Toward Functionaries Will Be Cancelled*, HA'ARETZ INTERNET EDITION, Dec. 12, 2000. It is unclear if the Minister of Justice, who is the minister in charge of the Companies Law, was an addressee of this policy paper.

613. The revisions were also suggested with regard to low tech companies, although it was acknowledged that the ability of these companies to physically emigrate is substantially lower, due to their dependence on physical assets. *See The Amendments to The Companies Law were Approved by the Ministers' Committee of Legislation and Passed to the Knesset's Constitution Committee*, Press Release, The Ass'n of Publicly Traded Companies (May 1, 2002), *available at* http://www.e-good.org.il/news/content.asp?ID=93.

memorandum that dealt with most of the issues raised by the Manufacturers' Association and other bodies, such as the Association of Publicly Traded Companies. The first draft of this bill memorandum was presented to the Prime Minister in December 2000, and its final version was approved by the Ministers' Committee of Legislation in April 2002.[614] The governmental blueprint passed the first reading in the Knesset on July 1, 2002.[615]

Interestingly, the revisions suggested by the amending bill were not limited to high tech companies (in fact, the official explanation did not even mention this sector), nor were they supplemented by a serious discussion of their repercussions.[616] Instead, the official explanation accompanying the bill settled for general statements regarding the protection of shareholders and the necessity to adopt a regulatory framework similar to that in western countries.[617]

While the Justice Ministry representatives were working to amend the bill and incorporate the comments of different bodies, a businessman named Yossie Hollander entered the legislative process.[618] Unsatisfied with the amendments suggested by the Justice Ministry, Mr. Hollander approached different legislative bodies and employed lobbyists in the

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614. *See The Amendments to the Companies Law were Approved by the Ministers' Committee of Legislation and Passed to the Knesset's Constitution Committee*, THE ASS'N OF PUBLICLY TRADED COMPANIES, PRESS RELEASES, May 1, 2002, *available at* http://www.e-good.org.il/news/content.asp?ID=93.

615. *See* THE COMPANIES BILL (AMENDMENT), 5762-2002 (FIRST READING) (NO. 324), D.K. (2002).

616. The foreword of the official explanation accompanying the amending bill states that in the course of the implementation of the new law, some issues that necessitate clarification or alteration were raised due to, *inter alia*, public discussion regarding the law's provisions. The bill, the official explanation proceeds, includes the main suggested amendments and is principally meant to amend substantial problems that were brought up. So, for instance, it is suggested to repeal the ability to attribute the company's duties to managers and directors, and to permit the insurance of directors against breach of 'duty of care' claims in case of a prohibited distribution. Moreover, additional amendments are suggested owing to comments received from different bodies, or for clarification purposes. *See* Companies Bill (Amendment), 2002, at 638.

617. *See generally id.*

618. *See* Vardi, *supra* note 278. Mr. Hollander, an entrepreneur in the high tech sector, was among the founders of New Dimension Software, Ltd., a company that was acquired by BMC Software Inc. in 1999 for $675 million, and is currently the Chairperson of the Board of Directors of Jacada Ltd. *See* http://www.jacada.com/news/fact_sheet.htm.

Knesset to further relieve investors and managers from over-regulation.[619] Once again, the claim was that a complicated and bureaucratic corporate law might cause entrepreneurs to incorporate their companies elsewhere.[620] His efforts resulted in a private bill that was signed by thirteen MKs and submitted to the Knesset on June 3, 2002.[621]

Envisioning a global competitive market for corporate charters, this bill reduced shareholder and director duties, as well as the doctrine of veil piercing, well beyond the relevant provisions in the governmental bill.[622] In doing so, the official explanation accompanying the private bill was that no similar legal provisions exist in Delaware's General Corporation Law.[623] The bill also made the separation between the

619. *See* Vardi, *supra* note 278.

620. *See A Group of Business Persons from the High-Tech Sector Asks MK Eitan to Amend the Corporations Law* (Feb. 9, 2002); *MK Eitan will Initiate an Amendment to the Corporations Law* (Apr. 9, 2002), *available at* http://www.miki.org.il; Moti Arad, Adv., *The Companies Law Hinders Growth*, GLOBES ELECTRONIC ARCHIVE (Jul. 16, 2002).

621. *See* The Companies Bill, 5762-2002, p/3792, *available at* http://www.knesset.gov.il/privatelaw/data/15/3792.rtf. An identical bill was resubmitted to the subsequent Knesset on Mar., 26, 2003, by ten MKs. *See* The Companies Bill (Amendment – Encouragement of Incorporation in Israel), 5763-2003, p/267, *available at* http://www.knesset.gov.il/privatelaw/data/16/267.rtf. [hereinafter the Companies Bill (Encouragement of Incorporation), 2003]. As was mentioned above, private bills, i.e., bills that are initiated by MKs rather than by the government, are required to pass a primary reading by the Knesset prior to entering a tripartite legislative procedure, similar to the one applied to governmental bills.

622. With regard to shareholder duties, it eliminates the duty to act in good faith or with fairness. It also establishes that a showing of a legitimate interest will overcome any claim of abuse of power by a shareholder. With regard to directorial duties, it also enables the insuring of directors for breach of duty of care when they acted recklessly. With regard to veil piercing, it creates an inclusive list of exceptional circumstances in which the court may lift the corporate veil towards the shareholders. This list consists of two causes: where there was an intent to abuse the law or to deceive a person, or where the company was managed intentionally against its interest. *See* Companies Bill (Encouragement of Incorporation), 2003.

623. *See id.* In the foreword, the official explanation notes that Delaware's corporate law is considered the most advanced law in the world and hence the Israeli corporate law should be examined in its light. No attention is given to the differences between the two jurisdictions.

chairperson and the CEO optional rather than compulsory.[624] In addition, the bill exempted companies that are traded on foreign exchanges, notably in the German Neuer Markt, from certain registration requirements[625] and regulated special forms of mergers, such as short-form mergers and mergers with foreign entities.[626] The private bill passed the primary reading at the Knesset on May 21, 2003, and, in agreement with the government and the initiating MKs, it was referred to the Constitution, Law, and Justice Committee to be prepared for legislation, in conjunction with the governmental amending bill.[627]

The Subcommittee of The Constitution, Law, and Justice Committee, on the Matter of The Companies Bill (Amendment) conducted 20 meetings discussing the governmental bill (the Companies Bill (Amendment), 2002), as well as the private bill mentioned above (the Companies Bill (Encouragement of Incorporation), 2003) and the Companies Bill (Qualification of Outside Directors), 2004.[628]

The resulting law, which passed the second and third readings on March 7, 2004,[629] includes both technical and substantive amendments. Among others, it restricts the contents of the doctrine of veil piercing and annuls its application to managers and directors;[630] it further erodes the prohibition of the chairperson from acting as the CEO of the company;[631] it extends the list of issues that the board may delegate to committees;[632] it narrows the definition of material private placement that requires special approvals;[633] it imposes legal fees of a plaintiff in a

624. *See id. See also* Moti Arad, Adv., *The Companies Law Hinders Growth*, GLOBES ELECTRONIC ARCHIVE (Jul. 16, 2002).

625. *See* Companies Bill (Encouragement of Incorporation), 2003.

626. *Id.*

627. *See* THE COMPANIES BILL (AMENDMENT – ENCOURAGEMENT OF INCORPORATION IN ISRAEL), 5763-2003 (NO. 24), D.K. (2003).

628. The Companies Bill (Qualification of Outside Directors), 2004 was based on two private bills that passed the primary reading by the Knesset on Feb. 18, 2004. *See* Prof. Yossef Gross, *Membership on the Board of Directors – Not only a Respected Way to Retire*, GLOBES ELECTRONIC ARCHIVE, Mar. 23, 2004.

629. THE COMPANIES BILL (AMENDMENT NO. 3), 5765-2005 (SECOND READING AND THIRD READING) (NO. 230), D.K. (2005).

630. *See supra* notes 352-63 and accompanying text.

631. *See supra* notes 406-09 and accompanying text.

632. *See supra* notes 418-23 and accompanying text.

633. *See supra* notes 439-44 and accompanying text.

derivative action on the company;[634] it further reduces the limitations on the individuals who are qualified to act as independent directors because of their relation to the company but at the same time it sets certain professional qualifications for such directors;[635] it excludes additional situations from the definition of a "personal interest" of a manager or director that necessitates a special approval mechanism;[636] it relieves directors' duties in the case of a prohibited distribution;[637] and it modifies certain issues of mergers and acquisitions.[638]

As already stated, the most common claim in favor of mitigating the mandatory provisions set by the new law, or limiting their application, emphasized the fear that Israeli companies would migrate to other countries, most notably the United States.[639] Practically, this migration could take two forms.[640] First, companies could incorporate in Israel and list their securities, exclusively or complementarily, on a foreign stock exchange.[641] Second, Israeli companies could incorporate in a foreign country.[642] While facilitating legal arrangements concerning companies that are incorporated in Israel but are listed abroad is essential, notwithstanding the complexity of the contents of such arrangements,[643] an overly broad revision that is driven by an amorphous

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634. *See supra* text accompanying notes 461-62.

635. *See supra* notes 479-82 and accompanying text.

636. *See supra* text accompanying note 496.

637. *See supra* text accompanying notes 509-13.

638. *See supra* notes 539-46 and accompanying text. These issues include narrowing down the definition of acquisitions that are required to be effected by way of a tender offer and foregoing shareholders' approval of certain types of mergers.

639. *See, e.g.*, Yadlin, *supra* note 185, at 273.

640. *See generally* Rock, *supra* note 154.

641. *See* Coffee, *The Future as History*, *supra* note 3, at 673-76.

642. The Israeli corporate law, like its American counterpart and as opposed to European corporate laws, applies the "state of incorporation" doctrine and not the "real seat" doctrine to the corporation's internal affairs. Thus, it enables corporate migration. For the differences between the two doctrines and the implications of the European Court of Justice 1999 *Centros* decision for the availability of regulatory competition in the European Union, see Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, Columbia Center for Law and Economics 49 AM. J. COMP. L. 329 (2001).

643. *See* THE SUBCOMMITTEE OF THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, FOR REGULATIONS UNDER THE COMPANIES LAW, 15TH KNESSET 2ND SESS., PROTOCOL NO. 10 (JAN. 11. 2000) (discussing the Companies Regulations (Companies

concern over reincorporation abroad raises some doubts regarding its motives. This is because such a concern ignores the complex set of factors that affect a company's decision of incorporation or reincorporation. In a nutshell, these factors include tax considerations, costs of incorporation in a foreign country, the political issue of being affiliated to Israel, and the overall business environment, of which the Companies Law is only a secondary component.[644]

In addition, since labor law and bankruptcy law are indifferent to the question of incorporation,[645] in order for companies to evade the Israeli "over-regulation," they should not only incorporate outside of Israel but also physically relocate their activity abroad. This option is less viable to low-tech companies due to lower labor mobility and country-specificity of assets.[646]

Finally, the ownership structures of Israeli companies that are listed, and perhaps also incorporated in the United States, are significantly less concentrated than those of Israeli companies listed only on the TASE.[647] As noted, one of the explanations given to the unique phenomenon of Israeli companies listed exclusively on foreign exchanges was the signaling of these companies that their quality is superior to their TASE-based counterparts.[648] This fact makes the argument that under-regulation will improve the quality of Israeli companies logically incoherent. Under current market conditions, it is unlikely that less regulation will result in dispersed ownership and better corporate governance, at least not in the short term.[649]

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whose shares are listed for trade on a foreign exchange), 5760-2000).

644. *See* Interviews with Saul Bronfeld, *supra* note 74; Shuki Abramovich, *supra* note 297; Prof. Uriel Procaccia, *supra* note 192; Dr. Shimon Wise, *supra* note 125.

645. *See* Interview with Davida Lahman-Messer, *supra* note 223.

646. *See* Coffee, *The Future as History*, *supra* note 3, at 654-57; *see also* Carles Boix & Luis Garicano, *Democracy, Inequality and Country-Specific Wealth* (2002) (Leitner International Political Economy Workshop), *available at* http://www.yale.edu/leitner/pdf/PEW-Boix.pdf.

647. *See supra* notes 158-61 and accompanying text.

648. See the discussion in Part II, *supra* notes 162-67 and accompanying text. *See also* Coffee, *The Future as History*, *supra* note 3, at 676 (noting that the difficulty of these companies in effecting an IPO in Israel may reflect the lack of sufficient minority legal protections to attract equity investors).

649. *Cf.* Licht, *supra* note 162 (arguing that cross listing is commonly motivated by access to cheaper finance and enhancing the issuer's visibility but that it is no quick-fix for corporate governance self-improvement. The latter must be achieved through

Considering the amendments to the Companies Law, 1999, in this setting gives rise to the argument that major innovations in the new law that were deliberated and discussed at length by the Barak Committee and the Parliamentary Subcommittee were perhaps discarded due to narrow political interests.[650] Thus, control holders and managers made sure that their liability and accountability in managing the corporation would not extend beyond the legal situation that preceded the legislation of the new Companies Law (and in some contexts would even be curtailed). At the same time, at least according to media reports, then Prime Minister Ehud Barak, who spurred the governmental amending bill, and some of the MKs, who initiated the private bill, honestly believed in the necessity of the revision in order to prevent the migration of high tech companies out of Israel, and in the balance it is supposed to set between business flexibility and the protection of parties that might be hurt, such as minority shareholders.[651]

These developments clearly demonstrate one of the mechanisms through which interest groups can gain influence on political actors, namely by controlling their flow of information. In a reality where MKs do not have access to independent sources of information,[652] the media coverage of corporate law issues is rather superficial,[653] and business persons have a direct route to MKs and government members, including the Prime Minister, the ability of business groups to influence legislators' decision-making is quite extensive.[654] This is all the more so

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regulation in firms' home countries).

650. *Cf.* Zvi Lavi, *Professor Procaccia and His Fight Against the Lobbyists*, GLOBES ELECTRONIC ARCHIVE, Sep. 11, 2003 (reporting on a letter that was sent by Professor Procaccia to the Constitution, Law, and Justice Committee, in which Professor Procaccia protests against the amendments suggested in the private bill and claims that the lobbyists' aim is to tilt the law in favor of managers and control holders of distressed companies, at the expense of investors and creditors).

651. *See* Koren, *supra* note 612.

652. *See supra* text accompanying note 251.

653. *See infra* text accompanying notes 741-42.

654. *See, e.g.*, *A Group of Business Persons from the High-Tech Sector Asks MK Eitan to Amend the Corporations Law,* Feb. 9, 2002, *available at* www.miki.org.il, the official website of MK Eitan who initiated the private bill (stating that "[t]he current situation in which Israeli Companies prefer to register abroad constitutes a severe danger to the State of Israel. Registration of companies abroad causes reduction in employment, fleeing of capital, brain drain, and substantial decrease in the tax base. . . .

when the political power of the government officials who are supposed to give a counter balance to the business sector is quite limited.[655] By manipulating the public discourse and preventing in depth systematic discussion, interest groups are able to portray to the legislature realities and facts that in essence serve their own interests, rather than the interests of the general public.[656]

Moreover, the story of the amendment of the bills, especially the Companies Bill (Encouragement of Incorporation), 2003, stresses the importance of procedural process, substantial deliberation, and wide representation of all relevant parties in reducing or balancing interest-group pressure on political actors. At least to a certain extent, these factors seemed to exist in the formal stages of the legislation of the Israeli corporate law. Their absence from some of the initiatives to amend the law lays bare their significance.[657] In this context, Professor Procaccia's letter to the Constitution, Law and Justice Committee that prepared the bills for legislation[658] may be seen as an attempt to create a wider dialogue regarding the core principles of the legislation. Indeed, this call seems to resonate in the meetings of the Subcommittee of The Constitution, Law, and Justice Committee, on the Matter of The Companies Bill (Amendment) that discussed amendment of the bills.[659]

Therefore, the adjustment of the Companies Law is a Zionist, national, and necessary action for preserving the competitiveness of the Israeli Market") (translated freely by author).

655. *See* Interview with Judge Michal Agmon-Gonen, *supra* note 203. *See also* Licht, *supra* note 164, at 336-41 (describing the caving in of the ISA in the face of continuing pressure from the TASE and prominent business persons in the case of the dual listing project).

656. *Cf.* Macey, *supra* note 23, at 231 ("[T]hus, the cost of obtaining and disseminating information about legislative issues often results in passage of special interest legislation by legislators who really believe they are acting in the public interest.").

657. *Cf.* Hadas Magen, *MK Rassabi: The Companies Law Deters Entrepreneurs due to the Ease of Piercing the Corporate Veil*, GLOBES ELECTRONIC ARCHIVE (Nov. 20, 2003) (quoting Davida Lahman-Messer, Deputy Attorney General, who argues that the governmental bill was formed after hearing from the representatives of the Manufacturers' Association and other groups and considers the comments raised by those groups while preserving the interests of investors at large. The private bill, according to Lahman-Messer, is a move that circumvents the compromise made by the Justice Ministry and pronounces one-sided interests).

658. *See supra* note 650.

659. *See, e.g.*, THE SUBCOMMITTEE OF THE CONSTITUTION, LAW, AND JUSTICE

The final product of this Committee, the Companies Law (Amendment No. 3), 2005, took after the more balanced government bill on most of the issues discussed by the Committee.[660]

Lastly, it is important to note that since the enactment of the new law, the ISA has taken an effective role in regulating public companies according to the law. Acting on the interface between The Companies Law and The Securities Law, it has used its power to interpret different provisions of the Companies Law.[661] In this capacity, it held that voting agreements among shareholders might preclude those shareholders from being counted in the one-third of disinterested shareholders that is required for the approval of certain conflict of interest transactions.[662] It also decided that the phrase "irregular transaction of a public company" includes irregular transactions that are performed by a fully owned private subsidiary of the public company.[663] In addition, it has encouraged the use of class actions by investors and made use of the

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COMMITTEE, ON THE MATTER OF THE COMPANIES BILL (AMENDMENT), 5762-2002, 16TH KNESSET, 1ST SESS., PROTOCOL NO. 1 (Sep. 7, 2003); 16TH KNESSET, 2RD SESS., PROTOCOL NO. 3 (Nov. 16, 2003).

660. *Compare* Companies Bill (Amendment), 2002 *with* Companies Law (Amendment No. 3), 2005. This fact did not prevent MK Michael Eitan, the head of the Constitution, Law, and Justice Committee, from thanking Yossie Hollander from the podium following the enactment of the amending law. *See* THE COMPANIES BILL (AMENDMENT NO. 3), 5765-2005 (SECOND READING AND THIRD READING) (NO. 230), D.K. (2005), AT 51-52.

661. The ISA is not authorized to enforce the Companies Law, 1999. Nevertheless, since certain of the Companies Law's provisions and regulations concern the ISA's activity, the ISA often interprets different provisions of the Companies Law in connection with its authority under the Securities Law to enforce disclosure requirements. For information about the ISA in general, see About ISA, http://www.isa.gov.il/english/template/default.asp?textSearch=&catid=1&pageId=7&active=prof (last visited Dec. 8, 2005).

662. *See* the ISA News Releases dated Jan. 23, 2002; Feb. 11, 2002; Feb. 26, 2002, *available at* http://www.isa.gov.il//news/defaultnews.asp?catid=1&active=pirsum.

663. *See* the ISA News Releases dated Feb. 4, 2002, *available at* http://www.isa.gov.il//news/defaultnews.asp?catid=1&active=pirsum. Note that this interpretation was explicitly rejected by the Parliamentary Subcommittee that prepared The Companies Law for legislation. *See* THE SUBCOMMITTEE OF THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, ON THE MATTER OF THE COMPANIES BILL, 5755-1995, 14TH KNESSET, 3RD SESS., PROTOCOL NO. 22, 16-23 (Mar. 15, 1998); 14TH KNESSET, 3RD SESS., PROTOCOL NO. 29, 91-94 (Oct. 1, 1998).

authority given to it under section 209 of the Companies Law, 1999, to subsidize those suits.[664]

However, the ISA is not empowered to directly enforce the provisions of the Companies Law. At most, it can demand that violating companies disclose "incriminating" information.[665] Pointing to the current situation of recurring violations and lack of real enforcement, the ISA has lately suggested to the Justice Ministry to establish and operate an enforcement mechanism for overseeing certain provisions in the Companies Law, such as the appointment of independent directors and an internal auditor, the approval of conflict of interest transactions, and the acquiring of control by means of a tender offer.[666] Moreover, it has suggested modifying the Companies Law in order to expand the definition of "personal interest" with regard to conflict of interest transactions, and to increase the percentage of uninterested shareholders required for the approval of these transactions, from one-third to one-half.[667]

Finally, although not authorized to set the qualifications of directors, the ISA drafted guidelines, according to which public companies will have to disclose, as part of their board's annual report, whether they employ directors who have financial and accounting

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664. *See* the ISA News Releases dated Dec. 18, 2002; Dec. 19, 2002; Dec. 23, 2002; Aug. 3, 2003, *available at* http://www.isa.gov.il/news/defaultnews.asp?catid=1&active=pirsum. Between the years 2000, when the Companies Law came into force, and 2002, the ISA has participated in subsidizing seven class action suits. *See* ISRAEL SECURITIES AUTHORITY, FINAL REPORTS 2000-2002. I was not able to locate the overall number of derivative suits and class actions submitted to the courts at that period of time. Nonetheless, correspondence with the ISA shows that between 2000 and Sep. 2002, the number of class action suits that were reported to the ISA was fifteen, out of which eight passed the primary stage of approval as a class action by the court. *See* Email from Shelly Udvin-Aharoni, Adv., Director of Class Actions and Public Inquiries Department in the ISA (Sep. 9, 2002) (on file with author).

665. *See* Interview with Amir Sharf, Deputy Director of the Legal Department, the ISA, in Tel Aviv, Isr. (July 12, 2002) (on file with author).

666. *See* Globes Service, *Israel Securities Authority Initiates a Revision That Would Authorize It to Enforce Part of the Companies Law's Provisions,* GLOBES ELECTRONIC ARCHIVE (Apr. 7, 2003).

667. *See* the ISA News Releases dated Apr. 8, 2003, *available at* http://www.isa.gov.il/ news/news.asp?ID=174&inPage=123&active=pirsum; *see also* the ISA News Releases dated Jan. 14, 2004, *available at* http://www.isa.gov.il/ news/news.asp?ID=221&inPage=71&active=pirsum.

skills.[668] The ISA hopes that setting this disclosure rule will have an actual effect on the structure of the board of directors in public companies.[669] In a similar manner, the ISA approved a draft of an amendment to the Securities Regulation compelling public companies to disclose whether they have adopted an ethical code regarding the behavior of officers, directors, and employees of the company.[670] It further appointed a public committee for examining a possible corporate governance code for public companies in Israel.[671]

It seems that the ability of the ISA to go ahead with these initiatives stems from the exposure of numerous accounting and corporate scandals in the United States and in Israel over the past few years, as well as from cooperation with business groups.[672] This did not prevent the Association of Publicly Traded Companies from criticizing these suggested reforms as over-regulating.[673] The overall outcome of the ISA initiatives remains to be seen, but some of their impact was already felt in the Companies Law (Amendment No.3), 2005, most notably with respect to the provisions requiring directors to possess certain professional qualifications.[674]

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668. *See* the ISA News Releases dated Sep. 7, 2003, *available at* http://www.isa.gov.il/news/news.asp?ID=197&inPage=95&active=pirsum.

669. *Id.*

670. *See* the ISA News Releases dated Oct. 19, 2003, *available at* http://www.isa.gov.il/news/news.asp?ID=200&inPage=89&active=pirsum.

671. *See* the ISA News Releases dated Sep. 20, 2004, *available at* http://www.isa.gov.il/news/news.asp?ID=260&inPage=34&active=pirsum.

672. For example, the regulations regarding the ethical code were drafted in cooperation with the CFO Forum – The Israeli Forum of Chief Financial Officers. *See id.*

673. *See* Amir Licht, *Cadbury is Not Always a Sweet Chocolate*, GLOBES ELECTRONIC ARCHIVE (Dec. 8, 2003).

674. The official explanation relating to those provisions explicitly refers to the ISA's guidelines on the issue. *See* Companies Bill (Qualification of Outside Directors), 2004. Another modification made by the amending law as a result of the ISA's input is the application of the special approval mechanism required with respect to the employment of a control holder by the company also to the employment of a relative of such control holder. *See* THE SUBCOMMITTEE OF THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, ON THE MATTER OF THE COMPANIES BILL (AMENDMENT), 5762-2002, 16TH KNESSET, 2ND SESS., PROTOCOL NO. 14 (Aug. 12, 2004).

B.4. Delegation to the Minister of Justice

The last group of modifications that occurred in the course of the legislative process is characterized by the delegation of authority to regulate different issues, some of them substantive, to the Minister of Justice, the minister responsible for corporate law legislation under the Israeli political configuration.

Political theory deals extensively with the issues of delegation and the theory of bureaucracy.[675] For current purposes it is sufficient to note that a decision to avoid delegation may ensue from a legislature's wish to limit discretion and minimize abuse of powers, and a decision to delegate authority may result from the legislature's desire to avoid accountability, not from efficiency considerations.[676] Moreover, the delegation of authority to regulators who act within existing legislation, as opposed to legislators who vote on the legislation, raises questions regarding the motives of the regulators, their sources of information, and their susceptibility to interest groups.[677]

Examining the modifications made during the legislative process shows that the delegation of authority to the Minister of Justice mostly occurred during the parliamentary stage of the legislative process.[678] Among others, the Minister was delegated the authority to regulate substantive questions with regard to the issue of postal vote and policy statements;[679] to exempt certain types of transactions from the conflicts of interest approval mechanism;[680] and to set presumptions and exemptions with regard to permissible distributions.[681]

The Subcommittee's protocols with regard to these issues demonstrate that the delegation technique was used, among others, to create gradual change and overcome potential impasses in the

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675. *See, e.g.*, RODNEY KIEWIET & MATHEW MCCUBBINS, THE LOGIC OF DELEGATION (1991); DENNIS C. MUELLER, PUBLIC CHOICE III 359-71 (2003).

676. *See* Kaplow, *supra* note 523, at 610 & nn. 141-42.

677. *See* Jack Hirshleifer, *Comments*, 19 J.L. & ECON. 241 (1976).

678. The reference here is to specific instances of delegation, beyond the general provision that authorizes the Minister of Justice to regulate matters that are required for the implementation of the new corporate law. *See* Companies Bill, 1995, § 425; Companies Law, 1999, § 366.

679. *See supra* text accompanying notes 370-73.

680. *See supra* note 415 and accompanying text.

681. *See supra* text accompanying note 482.

Subcommittee.[682] For example, delegating to the Minister of Justice the authority to regulate the issue of postal vote and policy statements was meant to facilitate the launching of an innovative mechanism in the Israeli law by gradually imposing it on the law's users.[683] Enabling the Minister to have discretion with regard to permissible distributions was the resolution for a disagreement between the representatives of the Justice Ministry and the Institute of CPAs about the definition of "profits" and application of the solvency test.[684] Similarly, the fact that the Minister was authorized to exempt certain conflict of interest transactions from the application of the statutory approval mechanism only after consulting with the ISA,[685] may suggest that this provision was drafted in concurrence with the ISA.

As opposed to the shift from bright-line rules to standards that occurred during the deliberations of the Barak Committee and that was driven, *inter alia*, from a doctrinal approach that espoused leaving wide discretion to the court, the delegation to the Justice Ministry during the parliamentary stage of the legislative process seems to have ensued from the practical understanding that this technique would allow for the resolution of unsolved specific disputes among the relevant disputant parties at a later time . Moreover, the Justice Ministry might have been expected to be more responsive to different interest groups and better versed in technical issues, such as postal voting or distribution, than an unspecialized court.[686]

On first impression, authorizing the Minister of Justice to exempt certain types of transactions from the conflict of interest approval mechanism and the set presumptions and exemptions with respect to permissible distributions may seem to benefit managers

682. *See also* Interview with Prof. Joseph H. Gross, *supra* note 224.

683. *See* THE SUBCOMMITTEE OF THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, ON THE MATTER OF THE COMPANIES BILL, 5755-1995, 14TH KNESSET, 2ND SESS., PROTOCOL NO. 11, 24-27 (June 18, 1997); 14TH KNESSET, 3RD SESS., PROTOCOL NO. 26, 61-64 (Aug. 13, 1998). As mentioned above, the regulations with regard to postal vote and policy statements, which are a prerequisite for the application of the mechanism, were only recently approved by the Knesset committee.

684. *See* THE SUBCOMMITTEE OF THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, ON THE MATTER OF THE COMPANIES BILL, 5755-1995, 14TH KNESSET, 3RD SESS., PROTOCOL NO. 23, 52-66 (July 7, 1998).

685. *See* § 284 of the Companies Law, 1999.

686. *See* Kaplow, *supra* note 523, at 608-11.

and control holders, since they have a direct route to affect regulation that can mitigate the stricter provisions set by the law.[687] However, taking into account the role of the Justice Ministry and the ISA in the legislative process, the delegation of these matters to the Minister of Justice is better seen as a practice that ensures future oversight by the regulators of substantive legal changes. With regard to postal vote and policy statements, the fact that the application of the law's provisions on these issues is contingent upon the enactment of regulations which were only recently approved, demonstrates the subtle way in which the TASE and the Association of Publicly Traded Companies were able to postpone costly regulation, notwithstanding the negative effect of the absence of such regulation on shareholder activism. Similarly, on the issue of the costs of ownership authorization, the Banks' Association was able to bypass the governmental amending bill, which suggested imposing such costs strictly on exchange members,[688] by suggesting to delegate to the Minister of Justice the authority to regulate ownership authorization as well as the circumstances in which such authorization will be subject to a fee.[689]

C. Political Theory Framework of the Israeli Corporate Law

Generally, the legislative process of the new Israeli corporate law seems to be consistent with the interest-group theory of legislation, as developed in this essay. That is, the game played is not "all or nothing," but rather a more subtle one, where the influence of interest groups is less noticeable by, and less objectionable to the general public. This is true especially with regard to a complex overall reform that receives salience mainly in professional circles. Thus, the new Israeli corporate law is indeed an extensive code revision adopted for modern times. It abolishes anachronistic legal arrangements and adjusts the law to current market realities and needs.[690] It codifies common law doctrines, such as

687. *Cf.* Hirshleifer, *supra* note 677.

688. *See* Companies Bill (Amendment), 2002, at 641-42.

689. *See* THE SUBCOMMITTEE OF THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, ON THE MATTER OF THE COMPANIES BILL (AMENDMENT), 5762-2002, 16TH KNESSET, 3RD SESS., PROTOCOL NO. 12 (Jan. 26, 2005).

690. Examples include: legalizing the one person company; modifying the majority rule required to amend the documents of incorporations by setting the default rule at

those relating to derivative suits, piercing the corporate veil, and dividend policy, and gathers previously scattered legislation, such as agency rules regarding promoters, and class action suits.

But it does more than that. In the name of the autonomy of private will and the freedom of the market, it claims to enforce mandatory legal arrangements *only* when these are needed to protect investors (shareholders and third parties) from market failure.[691] And these junctions – that is, the identification of a market failure, the study of its attributes, and mostly the legal arrangements offered to overcome it – are exactly the places in which interest groups can capture marginal benefits (or prevent marginal losses).

As detailed in the previous section, the dynamics in the course of each stage of the legislative process and the identity of the participants in each stage had a clear effect on the outcomes of the legislation. More specifically, the structure of the Barak Committee and the characteristics of the dialogue conducted in its meetings resulted in creating a code that is rich in standards, leaving ample discretion to the court. Notably, although most interest groups active in the economy at that time had an opportunity to comment on Professor Procaccia's work or to send their reservations to the Barak Committee, there was no vigilant involvement by any group that was not an active participant in the Barak Committee meetings, certainly not prior to the amendment of the Companies Ordinance with regard to fiduciary duties. This fact enabled the invitees to the Barak Committee, most notably the ISA, to gain broad influence and promote mandatory legislation, at a period of time when market crashes and financial scandals were widespread. In sharp contrast to their earlier participative behavior, interest groups other than regulators took the time and effort to actively participate in the later stages of the legislation, both in the Parliamentary Subcommittee and in the post-enactment proceedings.[692] The result was that major innovations of the Companies Bill, 1995, were modified and mitigated due to strong

50%; eliminating the ultra vires doctrine; adopting the organ theory with regard to the actions and intentions of those acting on its behalf; enabling a company to repurchase its own stock; shifting the focus of the board role from managing the company to monitoring its management; and regulating mergers and acquisitions.

691. Companies Bill, 1995, at 6.

692. *See, respectively, supra* text accompanying notes 257 and 615-16.

pressure from different groups.[693]

Hence, in fighting over the new Israeli corporate law, the more organized parties and those with access to the legislature won small battles but did not prevail in the war. The modifications made in the course of the legislative process with regard to issues such as piercing the corporate veil, voting by proxy, the separation between the chairperson and CEO of the company, and shareholder and manager duties, all seem to reinforce the stance of control holders in the Israeli market place. On the other hand, different initiatives of the ISA, most conspicuously the elaborate mechanism for approving conflict of interest transactions, appear to enforce corporate law through regulatory schemes. In between, the Justice Ministry, as the public administrator of corporate law legislation and regulation, endeavored to create the appropriate balance among the different interests involved, while incorporating its own ideological agenda on issues such as related companies and mergers and acquisitions.[694]

This is not to take any decisive normative position regarding the outcome of the legislation or the participation of interest groups in the legislative process.[695] On the contrary, the main inference from the Israeli case study is a positive one. Interest groups are part of the political arena and are here to stay. Any legislative initiative that ignores this fact and aspires to create an ideal solution may prove futile. Instead, corporate law legislation should take into account the interests of the different groups affected by the law and attempt to balance them. This may be the tradeoff necessary to get a second best legislation – not ideal but optimal.[696] The ways to achieve just that, as well as the main conclusions from the case study of the Israeli corporate law, are discussed in the next and final part of this paper.

IV. CONCLUSION

Interest-group theory seeks to explain how different groups and political dynamics affect the outcome of the legislative process. It does not, however, at least not as I interpret it, purport to furnish a full

693. *See supra* Part III.B.3.

694. *Id.*

695. For some normative implications for corporate law, see *infra* Part IV.D.

696. *Cf.* Macey & Miller, *supra* note 39 (discussing the agency costs that arise out of the inherent conflict of interest between shareholders and managers).

explanation of each and every provision of a law. Neither does it intend to depict a cynical world in which each participant is driven solely by a lust for narrow pecuniary benefits. Nonetheless, political theorists are in essence asking us to abandon the naïve view according to which legislators act solely and exclusively to benefit society at large.[697] The implication here is that if we had a better understanding of the political process and its impact on the real world, we could then begin to devise practical methods aimed at improving it.

As opposed to the United States, in which political analysis has carved out for itself a legitimate niche within the sphere of legal academic discourse, in Israel there are too few of these discussions underway to legitimize their influence on legislative processes.[698] To become a party to such a discussion, one is forced to either enter the realm of journalism, which for the most part is regarded as a sensationalist rather than an informative arena, or try to glean those undertone remarks that are not meant to be quoted, at least not with reference to their source. Thus, it comes as no surprise that when descriptions of actual legislative processes do find their way into a classroom, they usually come in the form of casual anecdotes. Only rarely are law students asked, at least implicitly, to think of such accounts as offering valuable insights into the various considerations that underlie enacted provisions. The danger here is clear, for to ignore the real world of lawmaking is to reduce significantly one's ability to make effective policy recommendations bearing some chance of adoption by the legislature.

This paper has tried to travel a different path, one that focuses on interest-group theory and its application to corporate legislation. By looking at corporate law through the lens of political theory, we have been able both to elucidate the role played by interest groups in the legislative process and draw some interesting comparative and

697. *See supra* Part III.B.

698. Two important exceptions in this regard are Procaccia, *supra* note 187 (describing, in general lines, the legislative process of the new Israeli Corporations Law) and Licht, *supra* note 164 (describing the Israeli dual listing project – a regulatory program aimed to lure Israeli issuers listed only on U.S. markets to list their stock also on the TASE). However, these articles treat the political process as a given fact that bears negative consequences on desirable legal arrangements and do not purport to discuss the implications of the political process for legislative reform.

theoretical inferences. In the ensuing sections of this part, I will recapitulate this study's chief findings with respect to the identity and impact of the interest groups involved in the process, the role played by the media, legislators' ideology, and normative implications for corporate law, and will then put forward a few policy recommendations.

A. The Identity and Impact of the Interest Groups Involved in the Legislative Process

American scholars have long recognized the uniqueness of Delaware's political environment as well as the essential role played by the interstate competition for corporate charters in limiting interest groups' power.[699] They further acknowledge the importance of the corporate bar in shaping corporate legislation in Delaware and in other U.S. states.[700] The Israeli experience this paper has been devoted to exploring can, however, help us to further refine these observations.

First, Israel's corporate law is a national unitary code; as such, it is expected to be influenced by multiple interest groups who are residents of its jurisdiction.[701] Nonetheless, and much akin to the U.S. experience, numerous interest groups such as dispersed shareholders, employees, customers, and suppliers were not involved in the legislative process that gave rise to the new law.[702] This fact can be attributed to collective action problems in the case of shareholders, customers, and suppliers, and to the existence of alternative and more direct channels of influence in the case of employees.[703] Regulatory limitations and structural flaws may further account for the absence of institutional investors from the political arena.[704]

As for creditors, the acknowledgement made by Professor

699. *See supra* Part I.B.

700. *See* Carney, *The Production of Corporate Law*, *supra* note 59, at 722-24.

701. In contrast, Delaware's corporate law is susceptible to the influence of fewer interest groups, since the assets of most corporations incorporated under it are located in other jurisdictions. *See supra* notes 55-56 and accompanying text.

702. However, as noted in Part II.C, the ISA and the Justice Ministry took it upon themselves to represent the interests of some of these groups, specifically dispersed shareholders. *See supra* text accompanying notes 548-53.

703. *Cf.* Roe, *supra* note 54, at 2541 (asserting that interest groups, other than shareholders and managers, may confine corporations by means external to corporate law).

704. *See supra* Part II.C.

Procaccia and the members of the Barak Committee as to the importance of creditor protection resulted in highly elaborate legal provisions regarding piercing of the corporate veil and capital preservation, whereas the active participation of the Banks' Association in the legislative process ensured the maintenance of creditor interests, most notably in the case of mergers.[705] And yet, when the Israeli Companies Law is looked at from a comparative perspective, it seems to entitle creditors to much less protection than the European Community's Company Law Directives.[706] This fact is best explained by reminding oneself of the extensive disclosure requirements mandated by the Israeli Securities Law and utilized to safeguard creditors,[707] and also by considering how the multiple roles played by banks in the Israeli economy can all too easily bring about conflicts of interest. Nor can one neglect the fact that, as mentioned above, other creditors were not represented in the legislative process.[708] A complementary explanation here is that the application in Israel of the "state of incorporation" doctrine, as opposed to the "real seat" doctrine so often used in Europe, together with the gradual facilitation of Israel's product and capital markets, may have been placing more competitive constraints on the ability of Israeli banks to protect their interests through participation in corporate legislation.[709] Such an explanation is reinforced when one

705. *See supra* Part II.B.

706. *See* Carney, *Political Economy*, *supra* note 59, at 323-25.

707. *See supra* notes 668-69 and accompanying text

708. One example in which the absence of small creditors might have harmed the protection given to them by the law is the issue of the submission of financial reports of private companies to the Companies Registrar. The Justice Ministry suggested imposing the submission of a summary of the financial reports in order to enable suppliers to receive basic information about the private companies with which they deal. The claim was that, as opposed to banks that are able to demand such information due to their strong status in the Israeli economy, small creditors are at a disadvantage when furnishing credit to limited liability private companies. The initiative of the Justice Ministry was halted by the Manufacturers' Association that emphasized the negative implications of the matter for the competitiveness of companies. *See* THE SUBCOMMITTEE OF THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, ON THE MATTER OF THE COMPANIES BILL, 1995, 14TH KNESSET, 2ND SESS., PROTOCOL NO. 9, 18-27 (Mar. 25, 1997); 14TH KNESSET, 2ND SESS., PROTOCOL NO. 10, 2-5 (Apr. 8, 1997).

709. *Cf.* Carney, *Political Economy*, *supra* note 59, at 311-18 (discussing the role of tariffs and common markets in limiting interest groups' power).

observes the move currently underway in the European Community to eliminate some of the creditor protections, most notably the minimum capital requirements, on the grounds that these are unnecessary, ineffective, and an impediment to organization.[710]

Second, the role played by managers and control holders (those two being indistinguishable here due to the concentrated nature of the Israeli capital market) in the legislative process of the new law seems to reinforce interest-group theory's notions, according to which "[m]anagement's legislative interests will become more intense in the face of personal losses as a result of corporate law, either from liability rules or from loss of their positions in contests for corporate control."[711] The involvement of organized groups, such as the Association of Publicly Traded Companies and the Manufacturer's Association, as well as of influential businesspersons in the post-enactment proceedings of the new Israeli corporate law, particularly underscores this point.[712] These groups demanded that there be a lessening of officer and director duties and liabilities, and an improvement in the ability of managers and control holders to initiate substantive changes in the company's structure without bringing into play the various approval mechanisms set by the law.[713] In their threat to exercise their exit option – that is, to opt-out of the Companies Law, 1999, and incorporate elsewhere – Israeli managers stressed the importance of having in place a competitive corporate law that attracts businesses to incorporate under it.[714] They did not, however, give any explanation as to how the specific revisions suggested would, if implemented, improve or at least preserve shareholder protection.

Third, one conspicuous difference between the American and the Israeli experience has to do with the degree of the local bar's involvement in formulating corporate law. In the United States, each

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710. *See, e.g.*, Werner F. Ebke, *Centros - Some Realities and Some Mysteries*, 48 AM. J. COMP. L. 623 (2000); *see also* Luca Enriques & Jonathan R. Macey, *Creditors versus Capital Formation: The Case against the European Legal Capital Rules*, 86 CORNELL L. REV. 1165 (2001).

711. *See* Carney, *The Production of Corporate Law*, *supra* note 59, at 728.

712. *See supra* Part III.B.3(b).

713. *See supra* notes 612-13, 629-38 and accompanying text.

714. See the official explanation accompanying the Companies Bill (Amendment – encouragement of incorporation in Israel), 2003, p/267, *available at* http://www.knesset.gov.il/privatelaw/data/16/267.rtf.

state bar is an organized group that, through its committees, lobbies for revisions in state corporate law.[715] In addition, the Model Business Corporation Act, which serves as a source of law reform for many state laws, was drafted by the American Bar Association.[716] By contrast, although representatives of the Israeli Bar actively participated in the Parliamentary Subcommittee meetings that led to the creation of the new Israeli corporate law, they were not the driving force behind the legislation. This international difference may bespeak a deeper collective action problem that is faced by Israeli lawyers when it comes to corporate legislation.

As noted before, the threat that existing Israeli companies will opt out and reincorporate in another jurisdiction is relatively weak. Even in such a case, companies still will require local lawyers to handle all matters relating to labor, bankruptcy, and tax laws.[717] Thus, the incentive is drastically reduced for Israeli lawyers to retain clients by improving and modernizing corporate law. Moreover, since most of the large Israeli law firms do not focus solely on corporate practice, but rather provide their clients with a full range of legal services, they could expect to derive only limited benefits from a wider participation in the legislative process of corporate laws.[718] Two other factors differentiating the United States from Israel with respect to the degree of bar involvement in corporate legislation are: within the rather narrow bounds of the Israeli legal community, no special esteem accrues to a lawyer from membership in a bar committee examining corporate legislation; and, due both to Israel's small size and certain common practices, some leading lawyers, and especially those who represent managers and/or control holders, rightly feel that they have more direct and efficient ways of approaching members of the Knesset or ministers.[719]

It also should be stated in this regard that the Israeli Bar, like those

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715. *See* Carney, *The Production of Corporate Law*, *supra* note 59, at 718-22.

716. *Id.* at 723-25. *See also* ROMANO, *supra* note 48, at 28-31.

717. *See supra* notes 646-47 and accompanying text.

718. In contrast, in matters that might affect lawyers' direct pecuniary interest, such as the establishment of a second shift in the courts, the Bar demonstrated a deep and lasting involvement. *See, e.g.*, Shmuel Daklo, *The Bar Agrees to the Second Shift – If the Parties will Consent In Advance*, GLOBES ELECTRONIC ARCHIVE (Oct. 2, 2003).

719. *See supra* Part III.B.3.

U.S. lawyers who practice in states other than Delaware that do not enjoy a specialized judicial system, has stressed the need for greater clarity and certainty in corporate legislation.[720] Again, as opposed to Delaware's lawyers, Israel's lawyers do not seem to encourage higher litigation costs. To date, they have not made much use of those class action and derivative suit mechanisms that have been put in place by the new law. One reason for this is perhaps the dismissal of most of these cases by the court on preliminary grounds.[721] Another may be that in the absence of any contingency fees, Israeli lawyers have no real incentive to file these suits.[722] In order not to shut the door completely on class actions, the Bar has recently voiced its disapproval of a draft of the Companies Regulations that advises the imposition of court fees on both plaintiffs and defendants who have settled or lost such suits.[723]

A comparison of the provisions identified by legal scholars as being of interest to the Delaware corporate bar (presumably due to the higher litigation related fees they generate) with their counterparts in the Israeli law produces rather perplexing results. Certain provisions said to benefit the Delaware Bar, e.g. the barring of directors from being indemnified for payments made in settlement of shareholder actions[724] and the futility doctrine that waives the need for a demand requirement in derivative suits,[725] are missing from the Israeli law.[726] And yet one

720. *See, e.g.*, statement of the Bar representative in the opening meeting of the Parliamentary Subcommittee, THE SUBCOMMITTEE OF THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, ON THE MATTER OF THE COMPANIES BILL, 1995, 13TH KNESSET, 5TH SESS., PROTOCOL NO. 1, 43-44 (DEC. 24, 1995).

721. *See* Interview with Arie Mientkavich, *supra* note 125 (criticizing the Supreme Court for practically repealing the mechanism of class action).

722. *Cf.* Miller, *supra* note 58, at 75-77 (offering the difference in fee rules as an explanation for the dissimilar treatment of derivative litigation by American and English corporate law).

723. *See* Hadas Magen, *The Justice Ministry Plans to Impose a Court Fee in the Amount of 2,000 Shekels on Class Action Plaintiffs*, GLOBES ELECTRONIC ARCHIVE (Mar. 26, 2003); *see also* Zvi Noah, *The Court Fees Make Plaintiffs Run Away*, GLOBES ELECTRONIC ARCHIVE (Jan. 6, 2005).

724. *See* Macey & Miller, *supra* note 39, at 513-14.

725. *See* Carney, *The Production of Corporate Law*, *supra* note 59, at 727.

726. Section 260(a)(2) of the Companies Law, 1999, enables a company to indemnify an officer or director against expenses (including attorneys' fees) incurred by that person in connection with an action brought against him or her by, among others, the company or in its name. Section 194 of the Companies Law, 1999, requires demand in all derivative suits.

finds in that law other features said to facilitate the litigation process; e.g. no requirement for plaintiffs to post security for expenses in shareholder derivative suits,[727] and a broad right to inspect corporate books and records, including lists of shareholders.[728] This apparent inconsistency suggests that, whereas the Delaware Bar may have actively lobbied for the enactment of the provisions just alluded to, their absence from (or presence in) the Israeli law may well have nothing to do with the Bar but rather be contingent on other factors, such as the lack of specialized courts [729] or the need to encourage shareholder suits as a way of monitoring managers and control holders. Then again, it is also possible that the commentators have simply overstated the benefits that have been derived by Delaware lawyers, and the conflicts that would arise between lawyers and shareholders as a result of the enactment of such provisions.

Lastly, another interest group that was active in the various stages of the legislative process that produced the Israeli corporate law is the ISA. As opposed to the situation in the United States, where corporate laws are enacted at the state level even though securities regulation is carried out at the federal level[730] (thereby keeping the SEC fairly uninvolved in formulating state corporate law), Israel's unitary system has led to a considerable blurring of the borderline between corporate and securities law.[731] Although the ISA is not formally authorized to enforce the Companies Law's provisions, it regularly interprets those provisions in order to impose the disclosure requirements of the Securities Law. It also exercises the option given to it under the

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727. *See* Macey & Miller, *supra* note 39, at 510-11.

728. *See id.* at 513. Under section 199(3) of the Companies Law, 1999, the court may order the company or the plaintiff to post security for the defendant's expenses in a derivative suit. The Companies Bill (Amendment), 2002, suggests erasing the words "or the plaintiff" from the language of the section. Section 184 of the Companies Law, 1999, gives shareholders an extensive right to review the company's documents.

729. *Cf. supra* Part III.B.1 (discussing the shift from bright-line rules to standards).

730. On the relationship between federal and state securities regulations, see ROMANO, *supra* note 48, at 3-4.

731. For example, the issues of class actions, takeovers, private placements, and conflict of interest transactions between a public company and its control holder all were regulated by the Securities Law, 1968, prior to their inclusion in the Companies Law, 1999.

Companies Law to subsidize class actions.[732] Since its boost in status in 1987, the ISA has been taking an active part in the legislative process and considerably impacting such aspects of the new law as the mechanism for approving conflict of interest transactions and the arrangements for mergers and acquisitions.[733]

The ISA, as opposed to the Justice Ministry which is, formally at least, indifferent to the franchise fees accrued by the State from the incorporation of companies in Israel,[734] has an obvious and direct interest in the development of the Israeli capital market and its stock exchange. When one adds to this the ISA's commitment to enforcement as a means of ensuring a fair and functioning market, one gains a better appreciation of the ISA's deep involvement in corporate legislation, as well as its current initiatives designed to empower it to directly enforce certain provisions of the Companies Law.[735] In notable contrast to some U.S. state bureaucracies, which may support interest-group legislation that benefits local constituencies and yet still be constrained by competitive capital and chartering markets,[736] the ISA seems to try to stimulate investment activity in the local capital market through mandatory regulation. Given the absence of jurisdictional competition, the ISA's involvement in the legislative process of the Israeli corporate law can be perceived as a counterbalance to the pressures being exerted by other interest groups, particularly managers and control holders.[737]

B. The Role Played by the Media

Political theorists have long pointed to the importance of the media and so-called salience, i.e. public visibility, in constraining special interest legislation.[738] As the Israeli experience shows, however, the actual role played by the media is somewhat more complex than that.

732. *See supra* notes 429-31 and accompanying text.

733. *See supra* Part III.B for the involvement of the ISA in particular arrangements.

734. *See* Interviews with Davida Lahman-Messer, *supra* note 223; Prof. Uriel Procaccia, *supra* note 192.

735. *See supra* text accompanying note 661.

736. *See supra* notes 59-64 and accompanying text.

737. *Cf.* Bebchuk & Hamdani, *supra* note 53, at 610 (discussing the advantages of mandatory federal law and noting that a federal regulator could allocate "more resources for developing and implementing legal rules that would enhance shareholder wealth in publicly traded companies").

738. *See supra* Part I.A.

To begin with, while well-reported market scandals may lead to legislative action that ostensibly benefits the public by regulating various market activities, the efficiency of such initiatives is not always obvious.[739] Moreover, once the media turmoil dissipates, the affected groups invariably act to reshape and mitigate the legal arrangements so as to restore some of their temporarily slighted interests.[740]

It also needs to be noted in this regard that, in Israel at least, corporate law issues tend to receive only superficial coverage; for journalists often simply take the interest groups' press releases at face value. This enables those groups to use the media not so much to convince the public, but rather to influence decision-makers, public officials, and legislators.[741] Put in the words of a representative of the Manufacturers' Association: "When we deal with such issues we use the media, because although the MKs know it was written by us – we do not conceal this fact – still, when you read it in the newspaper it has a more significant effect."[742]

When one adds to the above the loose working methods of parliamentary committees in Israel[743] and the easy access certain interest groups have to politicians,[744] one begins to doubt whether that chief mechanism offered to us by political theory as a means to overcome, or at least to reduce, the influence of interest groups on legislators – namely, regular media coverage – is really is all that it has been cracked up to be, at least when it comes to corporate legislation.[745] If anything, interest groups make use of the media to communicate their interests to legislatures. It takes coverage of market crises and major scandals to initiate legislation, which sometimes yields questionable results.[746]

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739. *See supra* Part III.B.2.

740. *See supra* Part III.B.3. This phenomenon is consistent with one of the conclusions reached by Schlozman and Tierney, according to which, interest groups would have greater influence on narrow, specific, and technical amendments than on the entire legislation. *See supra* text accompanying notes 25-28.

741. *See* Interview with Shuki Abramovich, *supra* note 297.

742. *Id.* (translated freely by author).

743. *See supra* notes 241-54 and accompanying text.

744. *See supra* text accompanying notes 567-73, 586-89.

745. *Cf.* Romano, *The Future of Hostile Takeovers, supra* note 44, at 490-503; Romano, *supra* note 42, at 297-300 (recording the absence of public opinion on the issues of takeovers and futures trading in the United States).

746. *See* Hadas Magen, *Lahman-Messer: Only in the Days of the Messiah*

C. Legislators' Ideology

Critics of interest-group theory seeking to debunk the notion of self-interested lawmakers have suggested that legislators in fact have their own particular viewpoint of the public interest, i.e. their personal ideology.[747] Later models of political theory, however, have treated legislators' personal ideology as a form of consumption by legislators, as distinct from "real" general interest policies that are hardly prevalent.[748]

The case of the Israeli corporate law strongly reaffirms the significance of personal ideology in corporate legislation. There is general agreement among the participants in the legislative process that produced the new law that both the Barak Committee members and the Justice Ministry representatives acted out of a deep commitment to promote the public interest as they envisioned it.[749] It is indeed arguable that this fact can furnish an additional explanation for various key aspects of the legislative process, such as the shift from bright-line rules to standards during the deliberations of the Barak Committee,[750] and the refusal of the Justice Ministry to extend the regulation to related companies.[751] Since neither the Barak Committee members nor the Justice Ministry representatives were elected officials, they were less accountable to voters than legislators and, hence, enjoyed greater policy discretion, also known as slack.[752] Theoretically, such slack could have

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Companies' Owners will Disclose how They Appoint Directors, GLOBES ELECTRONIC ARCHIVE (Dec. 31, 2003) (quoting Davida Lahman-Messer, Deputy Attorney General, who noted cynically that with the enactment of the Sarbanes-Oxley Act, the legislators of the Israeli Companies Law were relieved since, finally, there was a law that was worse than the Companies Law).

747. *See* Farber & Frickey, *supra* note 20, at 893-901 (underscoring the importance of a legislator's personal ideology is shaping that legislator's conduct). *But see* Jerry L. Mashaw, *The Economics of Politics and the Understanding of Public Law*, 65 CHI.–KENT. L. REV. 123, 143-49 (1989) (describing the methodological problems in measuring ideology and questioning its importance).

748. *See supra* text accompanying notes 29-34.

749. Davida Lahman-Messer, Deputy Attorney General, who is the person most identified with the formulation of the law, was recently referred to as "the lobbyist of the public good." *See* Zvi Lavi, *Professor Procaccia and His Fight Against the Lobbyists*, GLOBES ELECTRONIC ARCHIVE (Sep. 11, 2003).

750. *See supra* Part III.B.1.

751. *See supra* text accompanying note 547.

752. *See* Levine & Forrence, *supra* note 29, at 176-77.

been equally useful in implementing either special-interest policies that would have allowed the lawmakers to retain power or to enhance their wealth, or other policies that would have furthered the public good as they conceived it.[753] Although motivations are always difficult to ascertain, the fact that there are other plausible justifications to be made of the above-mentioned modifications,[754] and that there were no obvious self-interested advantages to be derived from them, seems to infer that we have personal ideology, rather than special interests, to thank for the drafting alterations.[755]

When one contemplates the notion of personal ideology and draws the distinction between the regulator's own view of the public interest and a general-interest policy, i.e. one that would be ratified by the public absent monitoring costs, the issue of the normative value of personal ideology is inevitably raised. The issue begins to seem all the more pressing when one acknowledges that not even general interest policies are necessarily efficient or normatively warranted.[756] This all brings us to the next section, which is devoted to a broader discussion of the normative implications of interest-group theory for corporate legislation.

D. Normative Implications for Corporate Law

It has been asserted by some critics of interest-group theory (who have noted how often such theory, when used in isolation from a normative baseline, produces misleading conclusions) that sound

753. *See id.* at 176-82.

754. The shift from bright-line rules to standards was justified by the conception that the development of substantive law by the courts will enable flexible and pragmatic solutions for companies. *See supra* notes 543-44 and accompanying text. The refusal to regulate the issue of related companies was justified by the fear that regulation would enable control holders to benefit themselves at the expense of minority shareholders. *See* THE SUBCOMMITTEE OF THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, ON THE MATTER OF THE COMPANIES BILL, 1995, 14TH KNESSET, 3RD SESS., PROTOCOL NO. 20 (Feb. 19, 1998).

755. *See* Levine & Forrence, *supra* note 29, at 181-82; *cf.* Roe, *supra* note 54, at 2538-39 (contending that the internal affair norm, which defers the regulation of the relationships among shareholders, and between shareholders to managers, to the state of incorporation, is driven by deference to manager-shareholder interests, as much as it is driven by personal ideology).

756. *See supra* note 35.

conclusions as to the "disproportionality" of a group's influence must be built upon a normative baseline showing the appropriate amount of influence by minority and majority groups.[757] In the context of corporate law, however, this difficulty is mitigated by the widely accepted view that the normative baseline against which a legislative act is to be measured is that of efficiency – which is to say the maximization of shareholder wealth.[758] And yet, this still leaves open the question of how the efficiency of legal provisions can best be measured.

For some time now, this question has been debated in the United States, as part of the ongoing and heated discussion of the efficiency (or lack thereof) of interstate competition for corporate charters. The corporate law of Delaware, the indisputable winner of that competition, has been found to be efficient based on empirical assessments of the value-enhancing effect of state law on the firms incorporated within it.[759] From a theoretical perspective, Delaware's gaining of the laurel wreath in that race-to-the-top has been explained as resulting from the combination of robust capital markets and flexible and enabling legal arrangements.[760] Despite the fact that recent papers entering into the debate on state competition for corporate charters have raised doubts about both the viability of competition and the efficiency of Delaware's rules, given that state's considerable market power, none of those arguments seems to have undercut the simple assertion that competition plays a vital role in working to uphold shareholder interests and in

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757. *See* Elhauge, *supra* note 35, at 48-59 (noting that the normative baseline can represent a standard of social desirability – such as influence in proportion to numbers, equality of results, equality of opportunity, or distributive justice – or some efficiency standard – such as wealth maximization, Pareto efficiency, or utility maximization); *cf.* Herbert Hovenkamp, *Legislation, Well-Being, and Public Choice*, 57 U. CHI. L. REV. 63 (1990) (criticizing welfare economics and the public choice effort to explain inefficient legislation).

758. *Cf. supra* note 21.

759. For an overview of the debate and the different empirical studies, see ROMANO, *supra* note 48; Romano, *The Need for Competition*, *supra* note 51, at 494-507. *See also* Daines, *supra* note 1.

760. *See* ROMANO, *supra* note 48. *See also* Strine, *supra* note 534, at 1263 ("[L]arge, publicly traded corporations rationally choose Delaware law because its preference for flexibility rather than rigidity allows corporate boards to structure corporate transactions in a manner best tailored to the particular circumstances their corporations face.").

limiting the power of interest groups.[761]

When one attempts to assess the efficiency of corporate law provisions within a unitary system such as Israel's that is more devoid, at least "in house," of jurisdictional competition, the efficacy of the product is less obvious.[762] A national noncompetitive regulator will, by the inherent logic of the situation, have less incentive to furnish its corporations with the most efficient regime than will a competitive regulator. Indeed the U.S. legal regime, characterized as it is by the unique feature of charter competition, has been proved to provide corporations with better shareholder protection and better developed capital markets than the corporate law of any other country.[763]

The preceding does not in any way imply, however, that transplanting American corporate law to other countries would yield efficient results.[764] Indeed, given institutional differences, such as concentrated ownership, an unspecialized judicial system, and inefficient markets, any attempt to replicate such efficient U.S. legal arrangements as enabling provisions in countries such as Israel might prove to be rash.[765] It also should be noted that, in contrast to those mandatory provisions found in European corporate laws that have been attributed to the participation in the legislative process of creditors, managers, and employees,[766] in Israel the vast majority of mandatory

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761. *See* Bebchuk & Hamdani, *supra* note 53, at 610 ("State rules do provide a potentially valuable safety valve that protects against huge deviations of corporate law from optimality.") (referring to Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulations*, 107 YALE L. J. 2359, 2387 (1998)); Kahan & Kamar, *The Myth of State Competition*, *supra* note 53, at 735 ("[W]e conclude that Delaware tends to offer more protection to shareholders than non-competing states . . . .").

762. *Cf.* Bebchuk & Hamdani, *supra* note 53, at 599-604 (asserting that in order to maintain its monopoly position, Delaware biases its laws in favor of judge-made, open-ended standards that produce efficiency costs); Kahan & Kamar, *the Myth of State Competition*, *supra* note 53, at 739-42 (claiming that the lack of competition causes Delaware law to be less predictable but more innovative than it would be in the presence of competition).

763. *See* Romano, *The Need for Competition*, *supra* note 51, at 542-43.

764. *See* Procaccia, *supra* note 187, at 303-04.

765. Note that, at least in the case of Israel, the hypothesis offered by Professor Procaccia about the development of a competition among the charters of the different corporations did not materialize.

766. *See supra* text accompanying notes 65-66.

provisions were initiated by regulators.[767] There have been only a few instances in which interest groups other than the regulators, most notably banks, have made use of mandatory provisions to protect their interests – such as in the case of mergers, and with regard to a creditor's right to file a derivative suit in the case of prohibited distributions.[768] More commonly, such groups have striven to mitigate the mandatory provisions in ways that suit their needs.[769] It is noteworthy in that context that both regulators and other interest groups have used market failure (or lack of market failure) rhetoric to back up their views[770] – a tactic that comes as no surprise to those political theorists who have long pointed to the use of public-interest rhetoric by legislators in an attempt to economize monitoring costs by generating public support for their agendas.[771]

No empirical research exists attesting to the impact of The Companies Law, 1999, on the value of a firm. There are, however, some studies by the ISA's Economic Department which show that regulatory intervention in voting-rights issues, and in requiring mutual fund managers to participate in general meetings of shareholders,[772] has curtailed the ability of control holders to personally benefit at the expense of outside shareholders.[773] Other empirical work indicates that

767. The reference is to the rules of veil piercing, voting by proxy, the separation between the chairperson and the CEO, conflict of interest transactions, independent directors, warranted distribution, and mergers and acquisitions. For a description of these rules, see *supra* Part III.A.3. The initiating regulators were the Barak Committee members and the Justice Ministry representatives, both acting out of personal ideology, and the ISA, whose involvement in corporate legislation may demonstrate what Bebchuk and Hamdani would refer to as an action of "loyal officials" who spend "resources for developing and implementing legal rules that would enhance shareholder wealth in publicly traded companies." *See* Bebchuk & Hamdani, *supra* note 53, at 610.

768. *See, respectively, supra* text accompanying notes 507 and 431.

769. *See supra* Part III.B.3.

770. *See, e.g.*, THE SUBCOMMITTEE OF THE CONSTITUTION, LAW, AND JUSTICE COMMITTEE, ON THE MATTER OF THE COMPANIES BILL, 1995, 13TH KNESSET, 5TH SESS., PROTOCOL NO. 1, 32 (Dec. 24, 1995) (in his opening statement to the Subcommittee, the representative of the Association of Publicly Traded Companies stated that according to his perception, most market failures are temporary and therefore should not necessarily be regulated by the Companies Law).

771. *See supra* note 33 and accompanying text.

772. *See supra* note 588.

773. *See* RUTI DAHAN & SHMUEL HAUZER, ISRAEL SECURITIES AUTHORITY, THE CONNECTION BETWEEN QUALITY OF MONITORING, VOTING RIGHTS IN SHARES, AND

the very nature of the corporate governance and ownership structure in Israel negatively impacts the quality of firms and shareholder protection.[774] While these studies were conducted prior to February of 2000 when the new Companies Law came into force, their observations with respect to Israel's ownership structure and the general characteristics of its capital market surely remain relevant to the current state of affairs.[775]

This brings us back to political theory. Although the efficiency of the new law has yet to be measured, evidence of the involvement of interest groups throughout the stages of the legislative process as well as its effect on the end product may have probative value.[776] It may provide us with some information indicating which legal arrangements came into being as a consequence of an arms-length struggle between the various interest groups and which were born out of a single, narrow, one-sided interest. Political theory predicts that the arrangements that were intensely fought over by a number of parties will be less susceptible to the disproportionate influence of one interest group,[777] and, as such, are more normatively desirable.

This paper has shown that the mandatory provisions of the new Israeli corporate law were a result of market scandals, the empowerment and improvement in the status of the ISA, and the responsiveness of the Barak Committee to the legislative initiatives advanced by certain MKs. The law's mitigating provisions, on the other hand, generally were the result of concessions made by the various interests involved in the process as a response to managers and control holders' call for restoring some of their interests. Similarly, delegating authority to the Minister of Justice has been used both to create gradual change and to overcome

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OWNERSHIP STRUCTURE IN A COMPANY (1997); SHMUEL HAUZER, YEHUDIT ROZENBERG & SHARON OFIR, ISRAEL SECURITIES AUTHORITY, TESTING THE EFFICIENCY CAUSED FROM THE DUTY OF PARTICIPATION OF MUTUAL FUNDS IN THE GENERAL MEETINGS OF PUBLIC COMPANIES (1999).

774. *See* Blass et al., *supra* note 104, at 84-86. *See also* La Porta et al., *Law and Finance*, *supra* note 2; La Porta et al., *Corporate Ownership*, *supra* note 72, at 492, 501; La Porta et al., *Investor Protection and Corporate Valuation*, *supra* note 72.

775. *See supra* Part II.A.

776. *Cf.* Jerry L. Mashaw, *The Economics of Politics and the Understanding of Public Law*, 65 CHI.-KENT L. REV. 123, 145-46 (1989) (making this argument when explaining the importance of public choice theory to the analysis of public law).

777. *See supra* Part I.A.

potential impasses in the Parliamentary Subcommittee. As for the shift from bright-line rules to standards, it at least in part seems to stem from the internal dynamics of the Barak Committee rather than from efficiency considerations.

Given these findings, one begins to see the importance of striking an appropriate balance among the various interests involved in shaping corporate legislation. To ignore certain groups at certain stages of the legislative process is only to risk having to later witness a resurgence of their narrow interests. Indeed, had more interest groups voiced their opinions during the Barak Committee meetings, the parliamentary stage of the legislative process might have been less polemic. Nonetheless, the overall outcome – which is to say, the arrangements put in place by the Companies Law, 1999 – can be deemed normatively warranted (even if still far from optimal)[778] when viewed from a political theory perspective, since they do reflect the interests of a wide range of groups.[779] In this respect, the legislative process that gave birth to the new law tends to considerably outshine the post-enactment developments.[780] It can also be asserted on the basis of our findings that when a legislature is ill informed, and when the media is not doing their hoped-for job of constraining interest groups, the significance of a public regulator who acts as a professional and impartial mediator cannot be overstated. Such is the case even when the price to be paid is some deference to the regulator's personal ideology.[781]

In summary, the implication of political theory for corporate law is that distinct market and political realities affect the likelihood both that a successful piece of legislation will be fashioned such that it is approved by the legislature and successfully enforced by the courts and the administrative agencies, and that its various different legal arrangements will prove to be efficacious. This paper has no reason to quarrel with those American legal scholars who assure us that vigorous competition, which constrains the power of interest groups, is the ultimate generator of shareholder wealth. It does however insist that in the absence of such vigor, a more highly regulated market is quite certainly the second-best

778. *See infra* Part IV.E.

779. *See supra* Part III.C.

780. *See supra* Part III.B.3(b).

781. In comparison to the United States, in the absence of interstate competition, the public regulator may be seen as the closest substitute for the corporate bar as the driving force behind statutory reform.

way we have of reaching this goal of maximizing shareholder wealth. Indeed, it goes one step further, suggesting that such tighter regulation may well be the only modality by which we can ensure the formation of competitive markets in the long run.[782]

E. Policy Recommendations

As noted earlier in this paper,[783] legal scholars, facing interest-group theory and the fact that "interest groups can be expected to exert disproportionate influence over outcomes,"[784] have begun to focus upon the role played by the judiciary in ensuring or attempting to ensure a public-regarding application of the law.[785] Be that as it may, in the case of corporate law it nonetheless remains true that the main factors affecting the desirability of resorting to a judicial decision are the expertise of judges and the judicial system's ability to furnish timely decisions. Thus, improving the quality of the enforcement of corporate law by the courts may necessitate an overall institutional reform. Too often, however, such reform simply is not feasible, given the political and economic restraints found in many countries. In such cases the onus inevitably falls back onto the shoulders of the legislature.

When one looks at legislative reform from the perspective of institutional design, two issues loom largest. First, the market structure of a country is likely to reflect the groups most prone to intervene in the legislative process and those parts of the legislation that they seek to influence. Preliminary planning of the legislative process' procedure – whether such process is undertaken by a governmental ministry or a parliamentary committee – can serve to attenuate the ability of interest groups to obtain significant benefits at the expense of other groups and/or the public at large. Such planning is especially vital when it

782. *Cf.* La Porta et al., *Investor Protection and Corporate Governance*, *supra* note 2, at 29 (noting that the regulation of financial markets is required in order to encourage their development and to improve investor protection).

783. *See supra* note 18.

784. *See* Farber & Frickey, *supra* note 20, at 901.

785. *See, e.g.*, Cass R. Sunstein, *Interest Groups in American Public Law*, 38 STAN. L. REV. 29 (1985); Macey, *supra* note 23; William N. Eskridge, Jr., *Politics Without Romance: Implication of Public Choice Theory for Statutory Interpretation*, 74 VA. L. REV. 275 (1988).

comes to such a complex matter as corporate law, for it can reduce the ability and/or the incentive of interest groups to gain control of the flow of information to the legislature.

In this regard, we can draw some instruction from everyday experience, for it suggests that when people are making a mutual effort, they tend to look hopefully toward the project's outcome rather than frontally attack it, even when the output of the mutual effort differs substantially from each individual's input. When, by contrast, a party is excluded, no binding loyalties or understandings can later induce it to accept the outcome of a process of which it was not a part. Indeed, the vigorous participation of the various interest groups who sat in on the meetings of the Parliamentary Subcommittee quite certainly occurred as an upshot of their absence from the meetings of the Barak Committee. Such participation perhaps also contributed to the reopening of previous understandings between the bodies that did take part in the earlier stage of the legislative process: the Justice Ministry and the ISA. In other words, the legislative process that produced the new Israeli Companies Law might have been less costly, and would maybe have produced different legal arrangements, at least on the margin, had more careful consideration been given at the outset to which groups would take an interest in the legislation's outcomes, and hence should have been included in early stages of its formulation. It seems likely that if more participants in the process had been given the chance to consistently deliberate, rather than just haphazardly comment, on Professor Procaccia's proposal, they would then have been able to choose from among a wider array of legal arrangements and to articulate certain practical reservations to theoretical suggestions. Correspondingly, the concessions made by the various interest groups could have resulted in stricter enabling provisions, instead of mitigating mandatory legal arrangements with the former structure then proving in the long run to be the best way of fostering competition for corporate charters.

Second, with regard to the substance of legislative reform, much thought must be given, as it seemingly too rarely is, to the basic question of whether a particular reform is politically feasible, i.e. likely to survive the different stages of the legislative process. History suggests that feasible reforms are either those built around tradeoffs that serve to separate existing coalitions and interests, or those that make the market more competitive and thereby undercut the ability of existing groups to oppose the change.[786]

Within the context of corporate law, it seems that the group most likely to resist pro-investor reforms is corporate managers (and in concentrated markets control holders as well) because this is the group that stands to suffer the greatest direct losses as a result of such reforms. The Israeli experience affirms this observation. It also indicates that tradeoffs constitute one inevitable aspect of any effective legislative reform. One finds it hard to imagine, for instance, that the interim recommendations of the Barak Committee with regard to manager and director duties – recommendations that included, among others, the creation of a special mechanism designated to oversee conflict of interest transactions – would have been enacted had it not been for the provisions pertaining to insurance and indemnification that accompanied them.[787] As for the provisions pertaining to veil piercing and the separation between the chairperson and the CEO, these have been attenuated, owing to those managers' objections that have led to the recent amendment to the Companies Law. As more than one of the participants in the legislative process that produced that law has conceded: The best is the enemy of the good.

Finally, the new Israeli corporate law may illustrate a noteworthy path toward the implementation of effective reforms in countries whose capital markets are not well developed and where ownership is fairly concentrated. It seems that, at least under these circumstances, one way to constrain managers and control holders is to empower another interest group – be it an administrative agency, a political entrepreneur, or a "loyal" public official – to pursue public-regarding goals. With time this group could be expected to accumulate sufficient political power to counterbalance the pressures exerted by other interest groups.

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786. *Cf.* La Porta et. al., *Investor Protection and Corporate Governance*, *supra* note 2, at 25 ("Consistent with the dominance of interest group politics, successful reforms have occurred only when the special interests could be destroyed or appeased.").

787. For a description of the events that led to the enactment of these arrangements, see *supra* text accompanying notes 575-83.

APPENDIX A: MAIN AMENDMENTS IN THE ISRAELI CORPORATE LAW AND THE LEGISLATIVE PROCESS OF THE COMPANIES LAW OF 1999[788]

1929 – Companies Ordinance
Enacted under the British Mandate, the Ordinance was an almost verbatim copy of the English Companies Act of 1929. It was amended various times before and after the establishment of the State of Israel in 1948.

1982 – The Minister of Justice asked Professor Procaccia of the Law Faculty of the Hebrew University of Jerusalem to draft a new and cohesive corporate code.

1983 – Companies Ordinance [New Version]
An official translation into Hebrew of the original Ordinance, this version replaced the former ordinance, but did not divert from its common law origins. It was amended several times, most notably with regard to the issues of independent directors (1987) and the fiduciary duties of Managers and Directors (1991).

1985 – The Minister of Justice appointed a public committee chaired by then Supreme Court Justice Aharon Barak that based its work on Professor Procaccia's proposal. A portion of the committee's recommendations was implemented as amendments to the corporate ordinance, e.g., the above-mentioned 1991 amendment.

1994 – The Barak Committee submitted its report to the Minister of Justice. The report was adopted by the Ministers' Committee for Legislation and submitted to the Knesset as the Companies Bill, 1995. Thereafter, the Knesset approved the blueprint at "first reading" – the first stage of a tripartite legislative

788. This overview is largely based on the official explanation accompanying the Companies Bill, 1995. *See also* Procaccia, *Crafting a Corporate Code from Scratch*, 17 CARDOZO L. REV. 629 (1996).

procedure. Following its passing, the bill was referred to a parliamentary committee that drafted it into legislation.

1999 – The Companies Law passed the second and third readings at the Knesset on April 19, 2000.

2000 – The Companies Law came into force as of February 1, 2000.

2002 – The Companies Bill (Amendment), 2002, was approved by the Knesset at first reading on July 1, 2002.

2003 – The Companies Bill (Amendment – encouragement of incorporation in Israel), 2003, passed the primary reading at the Knesset on May 21, 2003.

2004 – The Companies Bill (Amendment No. 3) (Qualification of Outside Directors), 2004, was approved by the Knesset at first reading on November 15, 2004.

2005 – The Companies Law (Amendment No. 3) passed the second and third readings at the Knesset on March 7, 2005.

APPENDIX B: LIST OF INTERVIEWS AND MEETINGS

1. Prof. Uriel Procaccia, of the Hebrew University of Jerusalem Faculty of Law, drafted the original proposal, which was the basis for the work of the Barak Committee, in Jerusalem, Israel (July 29, 2002).

Members of the Barak Committee:

2. President Aharon Barak, the Supreme Court of Israel, in New Haven, CT (Sep. 28, 2002).
3. Amihud Ben-Porat, Ben-Porath, Hamou & Co. Law Offices, in Tel Aviv, Israel (July 12, 2002).
4. Prof. Joseph H. Gross, Tel Aviv University Faculty of Law and Gross, Klienhendler, Hodak, Halevy, Greenberg & Co. Law Offices, in Tel Aviv, Israel (July 24, 28, 2002).
5. Prof. Meir Het, Chairperson of the TASE Board of Directors at the time of the appointment, and later Chairperson of Bank Leumi, in Tel Aviv, Israel (July 1, 2002).
6. Zeev Sher, then Legal Adviser of Bank Leumi, in Jerusalem, Israel (July 29, 2002).

Organizers of the Barak Committee:

7. Davida Lahman-Messer, Deputy Attorney General, the Justice Ministry, in Jerusalem, Israel (Aug. 11, 2002).
8. Judge Michal Agmon-Gonen, then the Justice Ministry, in Jerusalem, Israel (July 29, 2002).

Participants in the Barak Committee:

9. Sam Bronfeld, Managing Director, the TASE, in Tel Aviv, Israel (July 17, 2002).
10. Arie Mientkavich, then Chairperson of the ISA, in Tel Aviv, Israel (Aug. 9, 2002).
11. Dr. Shimon Wise, then Legal Adviser of the ISA, in Tel Aviv, Israel (July 31, 2002).

The Knesset Subcommittee of the Constitution, Law and Justice Committee on the matter of the Corporations Bill, 1995:

12. Dan Meridor, Chairperson of the Parliamentary Subcommittee during the 13th Knesset, telephone interview (July 7, 2002).
13. Eliezer Sandberg, Chairperson of the Parliamentary Subcommittee during the 14th Knesset, in Jerusalem, Israel (July 9, 2002).
14. Eran Rosman, then the Justice Ministry, in Tel Aviv, Israel (July 22, 2002).

15. Shuki Abramovich, Director of the Economy Division, the Manufacturers' Association of Israel, in Tel Aviv, Israel (Aug. 12, 2002).
16. Michel Ohayon, the Israeli Bar, in Tel Aviv, Israel (July 23, Aug. 12, 2002).
17. Amir Sharf, Deputy Director of the Legal Department, the ISA, in Tel Aviv, Israel (July 12, 2002).
18. Ruth Shikler, Deputy Chief Legal Adviser, Bank Leumi, Representative of the Banks' Association, in Tel Aviv, Israel (August 13, 2002).
19. Nathan Shilo, Legal Adviser, the Association of Publicly Traded Companies, in Tel Aviv, Israel (July 14, 2002).
20. Gad Soen, Managing Director, the Association of Publicly Traded Companies, in Tel Aviv, Israel (July 8, 2002).
21. Dr. Omri Yadlin, Tel Aviv University Faculty of Law, Representative of the Manufacturers' Association of Israel, in Tel Aviv, Israel (July 7, 2002).

<u>Others</u>:

22. Dr. Eyal Sulgenik, Chief Accountant, the ISA, in Tel Aviv, Israel (July 7, 2002).
23. Dr. Reuven Y. Hazan, the Hebrew University of Jerusalem Department of Political Science, in Jerusalem, Israel (July 9, 2002).
24. Dr. Menachem Hofnung, the Hebrew University of Jerusalem Department of Political Science, in Jerusalem, Israel (July 10, 2002).

APPENDIX C: SUMMARY OF MAJOR MODIFICATIONS MADE DURING THE LEGISLATIVE PROCESS

Issue	The Companies Ordinance [New Version], 1983 + Israeli Common Law	Professor Procaccia's Proposal	The Companies Bill, 1995	The Companies Law, 1999 (modifications from the 1995 Bill)	The Companies Law (Amendment No. 3), 2005
Piercing the Corpor-ate Veil	1. No general reference in the Ordinance, only particular cases in which shareholders or managers should be held personally liable for their companies' debt, such as in the case of misusing the company's seal or managing the business of a dissolving company fraudulently. 2. Common law doctrine, including enterprise theory.	1. Discarding the existing statutory causes for piercing the corporate veil. 2. Codifying the judicial causes of circumventing the law and creditors' deceit, and adding an independent cause of undercapitalization. 3. Introducing the doctrine of equitable subordination. 4. Imposing personal liability on managers and directors in the specific case of breaching the reporting duties of the company.	1. Defining the concept of veil piercing. 2. Listing, as non-exhaustive examples, the cases in which the court may pierce the corporate veil: where there exists a statutory stipulation, or intent to abuse the law, or to deceive or deprive a person. 3. Recognizing the subordination of a shareholder's debt. 4. Acknowledging the court's power to pierce the corporate veil for managers and directors under the same causes mentioned above. 5. Rich with standards.	1. Adopting undercapitalization as an explicit cause for piercing the corporate veil. 2. Enabling the court to restrict the future occupation of shareholders or managers and directors, to whom it attributes the company's duties.	1. Setting forth a reduced and exhaustive list of cases for piercing the corporate veil. 2. Abolishing the option of piercing the corporate veil for managers and directors. 3. Adding a knowledge qualifier in connection with the attribution of the company's duties to a shareholder.
Share-holder Activism	1. No reference in the Ordinance; general principles of agency apply to the situation of voting by proxy. 2. In practice, no voting of dispersed shareholders since, legally, ownership of shares belonged to a registration company rather than to investors.	1. Creating an enabling proxy process that regulates voting by proxy, shareholder proposals and inspection rights in a manner similar to the American legal arrangements on the issue.	1. Establishing the ownership right of an investor in the share. 2. Adopting the proxy process proposed by Prof. Procaccia, but making it mandatory for public companies.	1. Embracing a limited version of the mechanism set forth by the 1995 bill. 2. Confining the subjects on which shareholders of a public company may vote in writing. 3. Leaving a wide discretion to the Minister of Justice to regulate substantive questions. 4. The mechanism will come into force only after the publication of the regulations regarding its implementation; these haven't been published yet.	1. Imposing the costs of the authorization of share ownership on exchange subject to a determination by the Minister of Justice of circumstances in which ownership authorization will require a fee.
Chair-person/ CEO	1. No reference in the Ordinance. 2. A common practice for public companies to have their chairperson	1. Suggesting an enabling arrangement according to which: first, in any company (public or private) that has more than three directors, the CEO	1. Setting that in a public company the board chairperson will not act as the CEO and will not have the CEO's powers.	1. Stating that notwithstanding the said provision, the general meeting of the shareholders may authorize the chairperson to act as	1. Permitting an override also in cases where the number of dissenting non-control shareholders does

Issue	The Companies Ordinance [New Version], 1983 + Israeli Common Law	Professor Procaccia's Proposal	The Companies Bill, 1995	The Companies Law, 1999 (modifications from the 1995 Bill)	The Companies Law (Amendment No. 3), 2005
	act as their CEO.	will not act as the chairperson; and second, that in every public company, the chairperson would be elected from among the independent directors.		the CEO for a period of up to 3 years, if the majority vote included 2/3 of the non-controlling shareholders.	not exceed 1% of the overall voting rights in the company 2. Clarifying that the general meeting may use its authority repeatedly.
Delegation to Committee of the Board	1. No reference in the Ordinance.	1. No elaboration of the issues that can or cannot be delegated. 2. Suggesting that the law should not include a provision that enables delegation but rather, that a company that wishes to delegate powers to board committees will declare so explicitly in its bylaws.	1. Delegation is acceptable unless the bylaws state otherwise. 2. Listing the issues that the board cannot delegate to the active management. 3. Listing the issues that the board cannot delegate to a committee, but for its recommendation.		1. Reducing the list of the issues that the board cannot delegate to its committees.
Shareholder Duties	1. No reference in the Ordinance except the prohibition to act in a way that oppresses other shareholders. 2. Common law doctrine regarding fiduciary duties that apply to control holders who sell their shares (Cosoi). 3. Securities Regulations (conflict of interest between a listed company and its control holders), 1994 – setting a special procedural mechanism for approving irregular conflict of interest transactions.	1. Requiring that control holders exercise their control in good faith and in an accepted way. 2. Applying the same duty to any shareholder or other constituency member whose actions are pivotal to the company's operation.	1. Extending the duty to act in good faith and with fairness to any shareholder in the company. 2. Establishing that a shareholder should avoid using a company's business opportunity if it might harm the company's interest 3. Adopting a procedural mechanism for approving irregular conflict of interest transactions, not only with regard to control holders but also with regard to any shareholder.	1. While maintaining the duty of any shareholder to act in good faith and in an accepted way, the fairness duty is imposed only on control holders and shareholders whose vote is decisive. 2. Omitting the duty imposed on shareholders to avoid misusing the company's business opportunities. 3. Applying the procedural mechanism for approving irregular conflict of interest transactions only to control holders rather than any shareholder. 4. Instead of exempting from the special approval procedure a certain, concrete, closed list of transactions, delegating the authority to exempt certain types of transactions to the Minister of Justice.	1. Reducing the list of transactions that require special approvals. 2. Applying the special approval mechanism required with respect to the employment of a control holder by the company also to the employment of a relative of such control holder by the company.
Derivative Suit and Class Action	1. No reference in the Ordinance. 2. Common law doctrine	1. Codifying and elaborating the mechanisms for derivative suit and class action.	1. Adopting Prof. Procaccia's proposal and the Securities Law's provisions in establishing extensive	1. Facilitating the submission of class actions, compared to the former arrangement.	1. Setting that the fees of the plaintiff's attorney in a derivative suit will be set by the

Issue	The Companies Ordinance [New Version], 1983 + Israeli Common Law	Professor Procaccia's Proposal	The Companies Bill, 1995	The Companies Law, 1999 (modifications from the 1995 Bill)	The Companies Law (Amendment No. 3), 2005
	regarding derivative suits. 3. General civil procedure and the Securities Law - regulating class actions.	2. Regarding derivative suits: the right to file a suit is given to any shareholder or director; there is a demand requirement; and, contrary to former law, there is no contemporaneous ownership prerequisite. 3. Providing a pecuniary incentive to file both derivative and class action suits to the plaintiff itself rather than to its attorney and setting the reimbursement at a fixed rate.	arrangements for derivative suits and class actions in both public and private companies. 2. Extending the right to file a derivative suit in the specific case of a prohibited distribution also to creditors. 3. As opposed to Prof. Procaccia's proposal, the decision whether to grant reimbursement to the plaintiff and the amount of reimbursement is left to the discretion of the court.		court and paid by the company, unless the court decides for special reasons that the plaintiff should pay its attorney's fees.
Independ-ent Directors	1. Requiring every public company to appoint at least two independent directors to its board, to have at least one independent director on each of the board's committees, and to have an audit committee consisting of all the independent directors. 2. An independent director was defined as a resident of Israel, who did not have an economic relation to the company or its related company and did not have a material connection to the company's business management. 3. Establishing an external statutory committee composed of a judge, the head of the ISA, and the	1. Suggesting a model for public companies that enables the company to choose among two alternatives: a board in which the majority of the members is independent or a board with a monitoring committee that is composed of at least three members, all of them independent, and that has the powers conferred under American law to the audit, compensation, and nomination committees.	1. Taking after the arrangement established by the Companies Ordinance, but imposing the duty to appoint independent directors on the company rather than on an external statutory committee.	1. Establishing that the independent directors are to be appointed by the general meeting of the shareholders under a procedure similar to the one required for approving conflict of interest transactions. 2. Mitigating the qualifying conditions for independent directors.	**1.** Further narrowing the list of people who cannot be appointed as independent directors because of their relation to the company. 2. Providing that at least one of the outside directors appointed by a public company should have accounting and financial expertise and that the rest of the outside directors should have a professional qualification.

Issue	The Companies Ordinance [New Version], 1983 + Israeli Common Law	Professor Procaccia's Proposal	The Companies Bill, 1995	The Companies Law, 1999 (modifications from the 1995 Bill)	The Companies Law (Amendment No. 3), 2005
	chairperson of the TASE, whose role is to authorize the appointment of independent directors suggested by the company.				
Manager & Director Duties and Rights	1. Fiduciary duties were acknowledged by the Supreme Court (Cosoi) and later incorporated into the ordinance together with indemnification and insurance rights. 2. The Ordinance further set a special procedural mechanism for approving conflict of interest transactions. 3. The right of independent directors for information and experts' aid was added to the Ordinance as part of the general arrangement regarding independent directors.	1. Influenced by the American concepts of these issues.	1. Following the Ordinance's provisions with regard to fiduciary duties of managers and directors, and improving the procedural mechanism for approving conflict of interest transactions. 2. Enhancing manager and director rights.	1. Eliminating the provision regarding the duty of loyalty in the special case of related companies, which was suggested by the Justice Ministry in consultation with Prof. Procaccia and was added to the Companies Bill, 1995, prior to its approval by the Ministers' Committee for Legislation. 2. The only remnant of this provision is the exclusion from the definition of a "personal interest" of a manager or director in a transaction - an interest that necessitates a special approval mechanism of the transaction - a situation where he or she serves on both a company and its fully owned subsidiary.	1. Further excluding from the definition of "personal interest" situations where a manager or director in a fully owned subsidiary holds shares or options in the parent company, or where a manager or director serves on a number of fully owned subsidiaries of the same company.
Permiss-ible and Prohib-ited Distribut-ions	1. No explicit provision regarding the preservation of the company's capital. 2. Establishing that a dividend can be paid only out of profits and that a company cannot repurchase its own shares.	1. Defining the actions that are considered a dilution of the company's capital, be it through dividend, allocation of shares without an appropriate return, or the purchase of shares by the company itself ("distribution"). 2. Distinguishing between permissible distributions and distributions that are prohibited, that is, result in the reduction of the company's capital below a certain threshold set by the law. 3. Setting the threshold on the sum of the company's	1. Adopting the general framework proposed by Prof. Procaccia but setting a more restrictive threshold: the return received from the allocation of the company's shares (including the premium) and any profits that were capitalized. 2. Referring to "accepted accounting rules" in defining distributable profits contrary to Prof. Procaccia's proposal to clearly define the funds that can be distributed.	1. Eliminates the liquidity test. 2. Delegating to the Minister of Justice the authority to set presumptions and exemptions with regard to permissible distributions.	

Issue	The Companies Ordinance [New Version], 1983 + Israeli Common Law	Professor Procaccia's Proposal	The Companies Bill, 1995	The Companies Law, 1999 (modifications from the 1995 Bill)	The Companies Law (Amendment No. 3), 2005
		liabilities and "stated capital", which includes the stocks' par value in addition to any portion of the premium that the company did not exclude and any capitalized profits. 4. Setting two additional requirements for permissible distribution: solvency and liquidity.			
Director Liability for Prohib-ited Distribut-ion	1. No reference in the Ordinance.	1. Holding that the relevant basis of accountability in the case of a prohibited distribution is guilt, but that in cases where the director opposed the distribution and did all that could be done to prevent it, where the director relied in good faith on misleading information that would otherwise warrant the distribution, or where he or she did not know and did not have reason to know about the distribution, the presumption of breach of duty of loyalty would not apply.	1. Adopting the arrangement suggested by Prof. Procaccia.		1. Extending the legal presumption regarding the type of duty breached in the case of a prohibited distribution to include also duty of care, which, as opposed to duty of loyalty, is insurable. 2. Providing, however, that companies will not be able to exempt a director, in advance, from liability in this case.
M&A	1. Limited arrangements in the Ordinance and in the Securities Regulations (Tender Offer), 1994.	1. Prohibiting the acquisition of de facto control in a company in ways other than through merger or tender offer and forbidding the obtaining of control through piecemeal purchase of shares. 2. Facilitating mergers, including statutory mergers, and offering a new model for takeovers that is based on the unforced acceptance of the offer by the majority of the shareholders. 3. Adopting a decision rule, according to which,	1. Diverging from Procaccia's proposal only by enabling a creditor of the company to apply to the court to delay or prevent a merger, and by extending the appraisal right of minority shareholders to any case of a merger or tender offer by an existing control holder.	1. Substantially revising some of the 1995 bill provisions. 2. With regard to mergers, requiring, in addition to the approval by the shareholders' meeting in each of the merging companies, an approval of the merger by the boards of those companies, and this would not be given if there exists a reasonable doubt regarding the solvency of the acquiring company, following the merger. 3. Requiring that a merging company	1. Clarifying that private purchase of control need not be conducted by way of a tender offer. 2. Requiring the acquirer of more than 45% of the company's voting rights to do so by a tender offer, only if there is not another person who holds the same amount of voting rights. 3. Revising the shareholders' voting rule on merger, so that shareholders' approval of certain

Issue	The Companies Ordinance [New Version], 1983 + Israeli Common Law	Professor Procaccia's Proposal	The Companies Bill, 1995	The Companies Law, 1999 (modifications from the 1995 Bill)	The Companies Law (Amendment No. 3), 2005
		the shareholders' vote on a merger or tender offer will not include the votes held by the offeror. 4. Limiting managers' and directors' actions, in the face of a tender offer, to negotiating the improvement of a tender offer or searching for a "white knight." 5. Regulating freeze out mergers by granting an appraisal right to minority shareholders, who hold less than 10% of the company's shares, in the case of a forced sale of shares to the control holder. 6. The proposal does not regulate the private sale of control.		send the merger proposal to its secured creditors and notify its unsecured creditors about it. 4. With regard to takeovers, narrowing down the requirement that acquisitions of a control block be conducted exclusively by way of a tender offer, by applying it to only two cases: where no other person already holds a control block, or where as a result of the purchase the holdings of the acquirer will exceed 45% and no other shareholder holds more than 50% of the company's voting rights. 5. Explicitly exempting from the application of the above provision the purchase of shares in a private placement. 6. Conditioning a special tender offer on the acquiring of at least 5% of the company's voting rights. 7. As for poison pills, eliminating Prof. Procaccia's proposal to specifically ban specific "suspected" actions. 8. Providing for appraisal rights for minority shareholders only in the case of a freeze out merger.	types of merger is no longer required. 4. Providing that the mere holding of shares in a merging company that holds shares of the other merging company would not count as a holding in the other company (a holding that bans the shareholder from voting on the merger).

APPENDIX D: THE PARLIAMENTARY SUBCOMMITTEE ON THE MATTER OF THE COMPANIES BILL, 1995 – LIST OF INVITEES

Date of Meeting [789]	**Justice Ministry**	**ISA**	**The Companies Registrar**	**Ministry of Finance**	**The TASE**	**The Ass'n of Publicly Traded Companies**	**The Manufacturers Ass'n**	**The Banks Ass'n**	**The Israeli Bar**	**The Inst. of CPAs**	**Others**
12/24/95	6	2	1		2	5	5	1	2	2	Procaccia
12/31/95	3				1	3	1	1	1	1	Procaccia
1/14/96	4	2	1			2	2	1	2	1	Procaccia Ed Rock
1/21/96	4	2	2			2	2	1	3	1	Procaccia
1/28/96	4	3	2		1	3	2	1	2	1	
2/4/96	5	3	1		1	4	2	1	1	1	Gross Bank of Israel
2/18/96	3	2				3		1	1		Gross Bank of Israel
11/18/96	3	1	1	1	1	3	2		2	1	2 Bank of Israel
12/17/96	4	1	2	1	1	1		2	2		Bank of Israel
1/7/97	2		2	1	1	3		2	1		Gross
1/14/97	2	2	2	1	1	2		2	1	2	The Insurance Companies' Association (2) MK Shahal
2/11/97	3	3	1	1		1	1		1	3 (Gross) [790]	The Institute of Internal Auditors (5)
2/18/97	4	2	2	1		3	1	1	1	3 (Gross)	The Institute of Internal Auditors (4) Bank of Israel

789. The Parliamentary Subcommittee met in the course of two Knesset sittings. During the 13th Knesset, the Subcommittee conducted seven sessions. In its next cadence the Subcommittee conducted another thirty sessions.

790. Professor Joseph H. Gross, a member of the Barak Committee, participated in some of the Parliamentary Subcommittee meetings. According to the Subcommittee protocols, on the occasions noted, he represented the Institute of CPAs.

Date of Meeting [789]	**Justice Ministry**	**ISA**	**The Companies Registrar**	**Ministry of Finance**	**The TASE**	**The Ass'n of Publicly Traded Companies**	**The Manufacturers Ass'n**	**The Banks Ass'n**	**The Israeli Bar**	**The Inst. of CPAs**	**Others**
2/25/97	4	3				3	1	2	1		The Institute of Internal Auditors (3)
3/11/97	5	3	1	1	1	2	1	2	1	2	
3/25/97	4	2	2			1	5			2 (Gross)	The Insurance Companies' Association The Institute of Internal Auditors IDI[791]
4/8/97	4	4		1	1	2	1	1	1	2	The Institute of Internal Auditors
6/18/97	3	2	1		1	2	1	2	2		
7/1/97	3	2		1	1	3		2	1	1 (Gross)	Bank of Israel
7/8/97	3	2		1	1	3	1	1	1		
8/6/97	4	3			1	3		2			
8/7/97	2	3				3	1	2	1		
12/2/97	3	3		1		1	2	1	2		IDI
12/22/97	3	5	1	1	1	3	3	2	3		Bank of Israel
1/6/98	3	4			1	2	2	2 (Mientkavich)	1		
2/8/98	3	6	1		1	3	1	1	2		3 (?) 2 professors 1 judge
2/19/98	2	2			1	2	1	2	1		IDI
3/10/98	3	5		1	1	3	1	2	3		
3/15/98	3	4			1	2		1	2		2
7/7/98	3	5	1	1	1	4	1	2		2	1
7/14/98	3	7		1	1	3	2	1	1	1	1 Gross
7/21/98	4	4	1	1	1	3	2	2	1		Antitrust Authority Procaccia Tax advisors' Bar
8/13/98	2	1				1	2				
8/23/98	3	3				3	2		1		

791. The Israel Democracy Institute (IDI) is an independent research center for policy studies.

Date of Meeting[789]	**Justice Ministry**	**ISA**	**The Companies Registrar**	**Ministry of Finance**	**The TASE**	**The Ass'n of Publicly Traded Companies**	**The Manufacturers Ass'n**	**The Banks Ass'n**	**The Israeli Bar**	**The Inst. of CPAs**	**Others**
9/17/98	2	2				2		1	2	3	The Institute of Internal Auditors (3)
10/1/98	3	3			1	2	2	1	1		The Institute of Internal Auditors (2) 1
10/27/98	3	3				2	2	2	1	2 (Gross)	The Institute of Internal Auditors (6) Tax advisors' Bar (2) State Comptroller (2)

Notes & Observations